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

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

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 what 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 patters of accounting regulation, and 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.

CONTENTS

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

1 INTRODUCTION

OECD accounting systems 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 (financial) globalisation as a driver and explanation for the convergence[1] of financial reporting systems. The changes in laws and regulation are an incremental development (Zimmermann et al. 2010). As we will show in this paper, 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 co-evolutionary 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 and 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 coalescence of financial systems, which leads to a more homogeneous stakeholder demand structure.

Globalisation has changed the corporate environment in many ways: corporations are now physically operating around the world in widely extended networks. They also do so financially: They raise money on foreign markets and companies’ stock is traded across borders. The liberalisation of capital flows, which followed increased demand for financial resources to make operating globalisation possible, and the ensuing financial

[1] In this context we specifically talk about *delta* convergence, meaning that reporting systems with a focus on conservative accounting approach reporting systems with a focus on information accounting (Heichel et al. 2005; Werner 2008).

globalisation have in general led to a stronger role of outside finance. The recent global crisis has perfectly demonstrated the coalescence of the corporate and financial world.

The accounting systems have developed in response to the legal, financial and cultural systems of nation-states, resulting in highly diverse, country specific accounting systems (Soderstrom and Sun 2007). In recent years, the different national 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 is naturally connected 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, because the cost of capital can be lowered by reducing information asymmetries between worldwide investors and the company (Hail and Leuz 2006). Comparable, information accounting rules sets[2] might lead to a more efficient allocation of the world's supply of capital, which could lead to 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, which want to increase their liquidity by attracting trade in stocks. Therefore, large stock exchanges also ask for financial reports prepared in accordance to International Financial Reporting Standards (IFRS) or US Generally Accepted Accounting Principles (US GAAP). So do national regulatory authorities, which are interested in the competitiveness and stability of capital markets (Coffee 2002). The latest developments indicate that the convergence of financial reporting systems is not only leading to a system that is modelled on an Anglo-American informational style, but to a single set of rules, which is likely to be the now pre-eminent set of IFRS (Chua and Taylor 2008) — even the US Security and Exchange Commission (SEC) plans to mandate the use of IFRS for listed companies in the US beginning in 2014.

The paper will discuss reasons and present evidence for the 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 sets of information accounting rules, 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

[2] 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 International Financial Reporting Standards (IFRS) have a clear focus on decision usefulness and will thus be named *information accounting rules sets* in the following.

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 designs, which appear to fall into two categories: 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).[3] 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 of how globalisation pressures the convergence of accounting systems. In the fourth section we present evidence for the concurrence of globalisation and accounting harmonisation. 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 a driver for the harmonisation of financial reporting; however, we refrained from the latter approach due to modelling considerations (e.g. level effects of globalisation, differential time lags of the driver, see section four). Section five concludes.

2 THE COALESCENCE OF THE CORPORATE WORLD

The most apparent reason for accounting harmonisation — the worldwide use of sets of information accounting rules like the IFRS — is the evolvement of multinational entities (MNEs) that do business the borders of their country of incorporation. Globalisation promotes the development of MNEs and is itself amplified by MNEs. Technical innovations e.g. advanced communication, the possibility of mass production and global trade along with decreases costs of transports around the world changed the environment of companies (Levitt 1983). These innovations have increased the opportunities available for MNEs, which has lead further growth in their number and size.

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. The evolvement of

[3] 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.

MNEs and globalisation in general is closely connected to technical innovations (Chandler 1992). Major technical innovations mark the four phases of the industrial revolution. Some general developments leading towards globalisation had already started during the first phase of the industrialisation in the 19th century. The first MNEs developed throughout the second phase of the industrial revolution from 1860 to 1914 when, most notably, engines with oil as fuel and the telephony were invented. A major reason for the internationalisation process of companies was the realisation of economies of scale (Kuznets 1971). The third phase, from 1915 to 1950, was on the one hand propelled by the development of large-scale production. On the other hand the internationalisation process was retarded by the political situation and protectionism. The fourth phase of the industrial revolution started around 1980. New communication and transport technologies as well as the possibility of free trade of goods, services and capital started an unprecedented process of internationalisation. In the fourth phase, the reasons for companies to internationalise became more complex than 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 the companies' home countries nor through debt or internal financing. Hence, besides international trade and foreign direct investments (FDI) activities, companies started to raise capital on foreign markets.

To provide some empirical evidence for the rapid development of globalisation since the 1980s, Exhibit 1 presents transportation and communication costs, Exhibit 2 displays FDI and Exhibit 3 shows global mergers and acquisitions (M&A).

Exhibit 1: Transport- and communication costs

Year	**Telecommunication***		**Sea freight***		**Air freight***	
	Index	**in US Dollar**	**Index**	**in US Dollar**	**Index**	**in US Dollar**
1930	100.00	244.65	100.00	60.00	100.00	0.68
1940	77.05	188.51	105.00	63.00	67.70	0.46
1950	21.75	53.20	56.70	34.00	44.10	0.30
1960	18.75	45.86	45.00	27.00	35.30	0.24
1970	12.91	31.58	45.00	27.00	23.50	0.16
1980	1.96	4.80	40.00	24.00	14.70	0.10
1990	1.36	3.32	48.30	29.00	16.20	0.11
2000**	0.35	0.86	35.00	21.00	11.80	0.08
2005	0.12	0.30	–	–	–	–

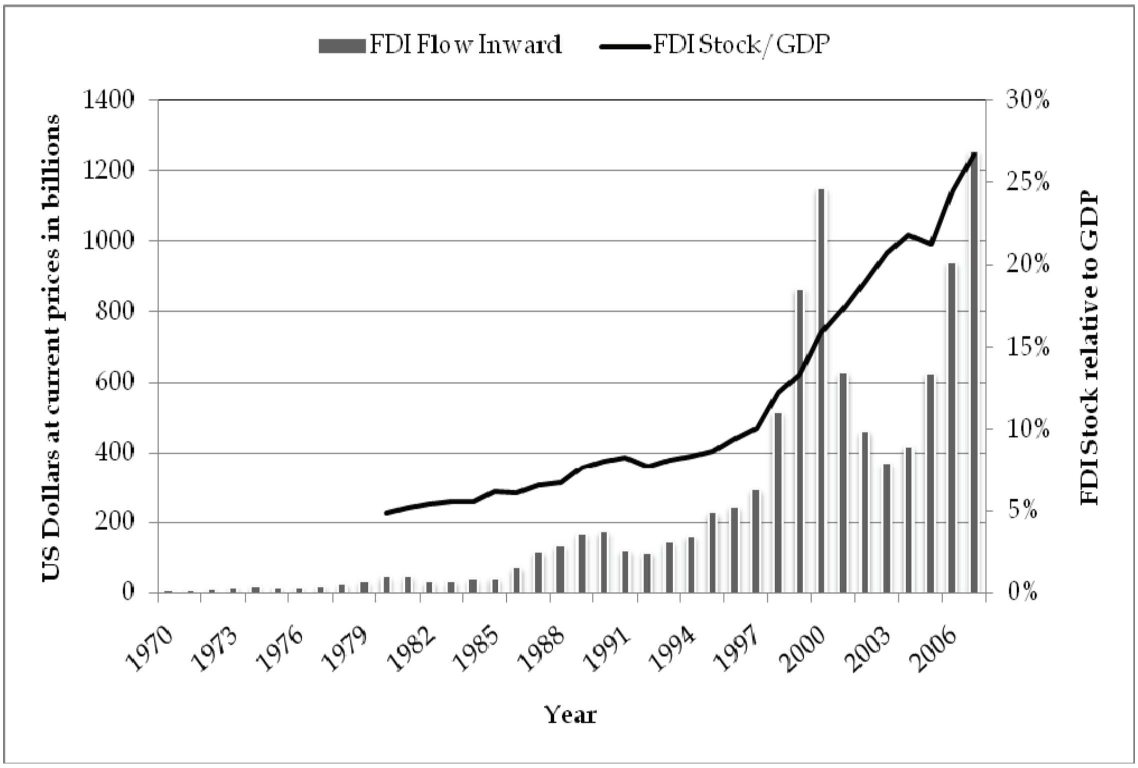
Data Sources: Busse (2001); Bundesverband der deutschen Industrie (2002).

Notes: * Costs for a three minute call from New York to London / average costs for sea freight per short ton (907.17 kg) / average air freight turnover per passenger and mile. ** Data for sea- and air freight from 1998.

Decreasing prices for communication and transportation show that the worldwide activity of companies became more feasible and more cost-efficient during the 20th century. Exhibit 1 illustrates these costs exemplarily for the facilitation of worldwide activity. The costs for seafreight and airfreight fallen by 65 and 88 percent, respectively, since the 1930s. Technical innovations and higher demand lead to a loop of falling prices through economies of scale and even more technical improvements. Moreover, the liberalization of markets had a positive effect on costs. These cost reductions and the development of a global transport and communication network made the coalescence of the corporate world possible in the first place, and it led to a self-enforcing process of globalisation.

The amount of goods transported rose significantly from the 1970s. For example the amount of worldwide sea freight doubled in the years form 1970 (10,654 billon ton-miles[4]) to 1995 (20,187 billon ton-miles).[5] In 2004, 27,635 billion ton-miles were shipped across the oceans.

Exhibit 2: OECD FDI flow (1970-2007) and FDI stock relative to GDP (1980-2007)



Data Source: UNCTAD, database.

One of the most common indicators to quantify globalisation is the flow of FDI. Exhibit 2 shows that FDI flows inside OECD countries have increased since the beginning of

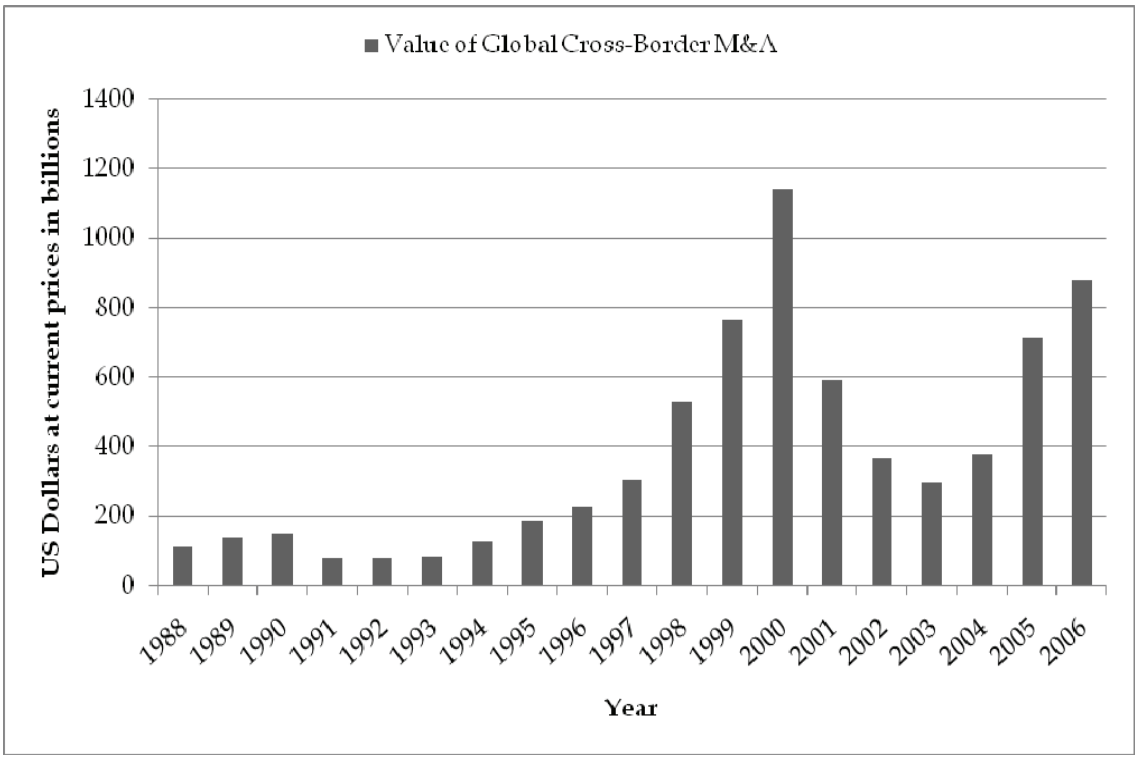
4 Transport of one ton of cargo over one sea mile.

5 C.f. Fearnresearch 2004.

the 1970s. The growth was especially pronounced in three periods: at end of the 1970s, from 1985 to 1989 and from 1995 to 1999. This shows that there are certain periods when the globalisation of the economy is especially proceeding while growth rates are even negative during other time windows. After a peak in 2000, the flow of FDI was lower for the following three years, but has been increasing every year since 2004. Since the late 1970s FDI have increased from about 35 billion US Dollars 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.

While the previous indicator measures the trade flows across the globe, global M&A can show how corporate networks evolve. Exhibit 3 shows the increase of global cross-border M&A from 1988 to 2006. Again there has been a significant increase since the 1990s and a drop between 2000 and 2003. However, the amount of global cross-border M&A in 2006 was over four times the amount in 1995.

Exhibit 3: Global cross-border M&A (mergers and acquisitions), 1988-2006

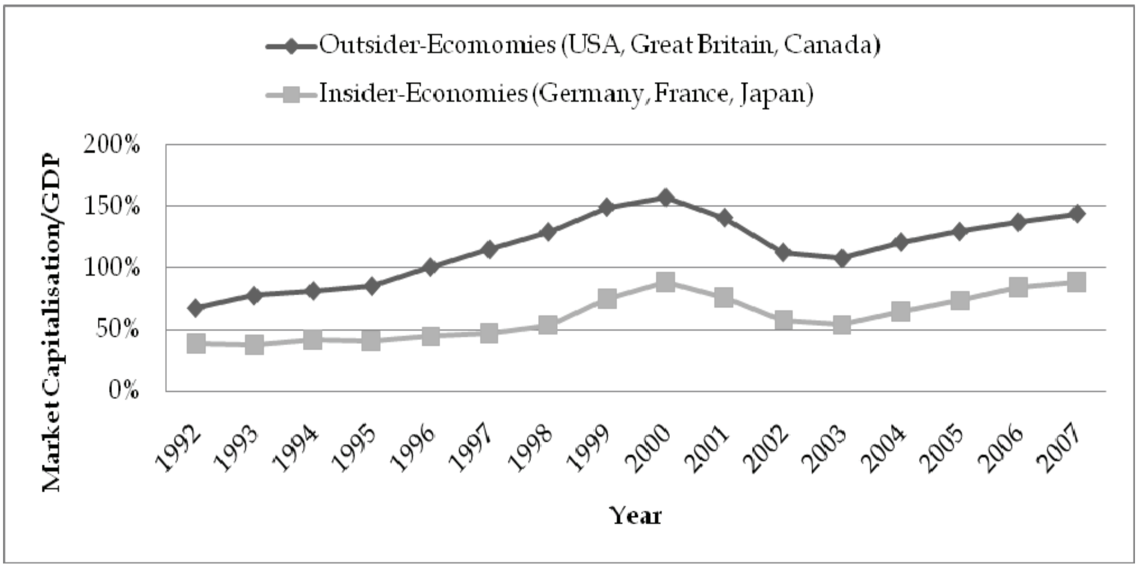


Data Source: UNCTAD, database.

Closely connected to the coalescence of the corporate world is the integration of capital markets. MNEs started to use foreign markets to raise capital to a much larger extent. Exhibit 4 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 (Allen and Gale 2000), the exhibit illustrates the general growth of equity markets. Historically, equity capital was relatively more important in outsider economies than debt capital (Wüstemann 2003), and debt raised through the markets was more important than credit raised through banks. However, outsider systems still show a dispersed owner-/holdership in contrast to the family-dominated and bank-financed entities in insider economies (Dutzi 2005). As a result the information asymmetries of shareholders in outsider economies are higher.

Exhibit 4 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. Furthermore, these results are in line with other studies (see, e.g., Obstfeld and Taylor (2004)).

Exhibit 4: Share of market capitalisation relative to GDP

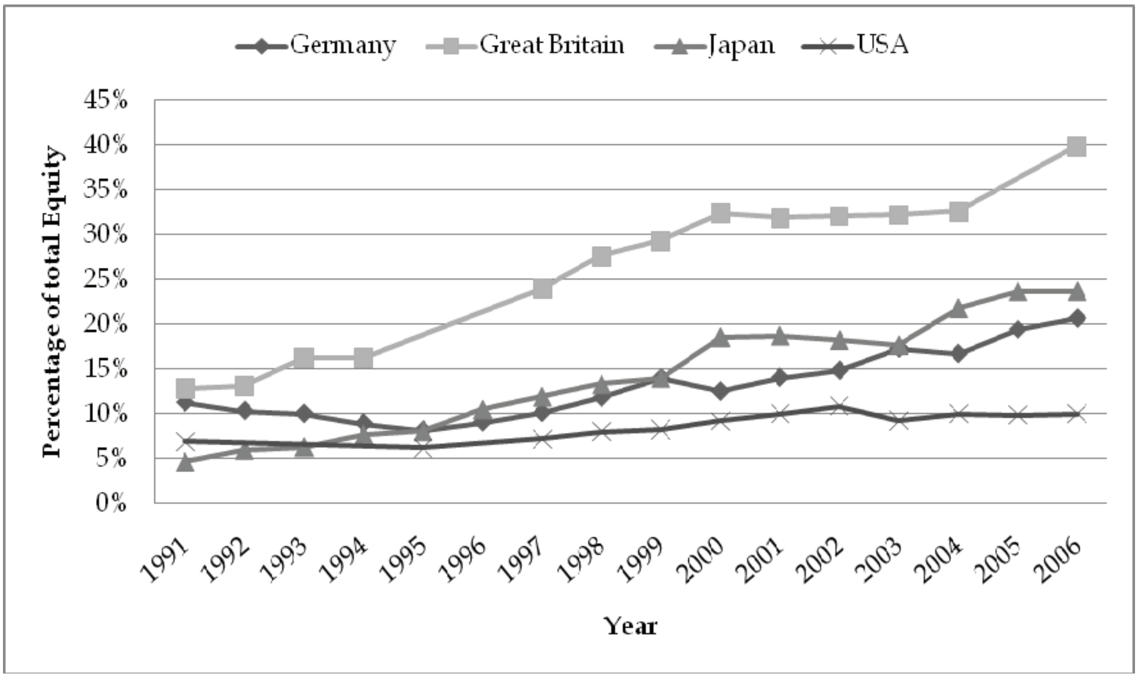


Data Sources: World Federation of Exchanges, IMF, DAI Factbook 2008.

A growing use of capital markets does not necessarily encompass their integration. The share of foreign investors, the share of foreign stock turnover or the equity issues on foreign markets are good proxies to measure internationalisation. 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 5 shows the share of foreign equity investors in Germany, Great Britain, Japan and the US. The data illustrates that capital markets were only slightly internationalised in this respect in the beginning of the 1990s. Since then, the share of foreign investors in 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 London Stock Exchange (LSE) launched in 1995. In general, the use of foreign markets has been facilitated by the emergence of electronic trading systems.[6] The automation of the trading processes facilitates security trading around the world at high speed and low cost.

Exhibit 5: Share of foreign equity investors



Data Source: DAI Factbook 2007, Federal Reserve Board "Flow of Funds" Sep. 2009, data for Canada and France not available

Exhibit 6 shows the turnover of foreign shares on the major stock exchanges of the selected countries. It also reveals a growing integration of markets: Just 1.93 percent of Germany´s total share turnover was from foreign shares in 1990. A decade later, 14.69 percent of share turnover in Germany could be assigned to foreign shares. In August 2007 the ratio was 12.73 percent. The same pattern holds for the other OECD countries. At the Paris stock exchange, the total turnover of foreign shares increased from 4,598 million US Dollars in 1990 to 10,390 million in 2000. The Euronext had an annual turnover of foreign shares of 19,445 million US Dollars in 2006. For the LSE, however, about 45 percent of the total turnover already came from trades with foreign shares in 1990. The ratio also increased to about 60 percent in 2000, but went back down to 41 percent in 2007. NYSE’s turnover ratio of foreign shares increased from about five per-

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

cent in 1990 to about nine percent in 2007. The turnover data points to growth rates for internationalisation being larger in insider countries.

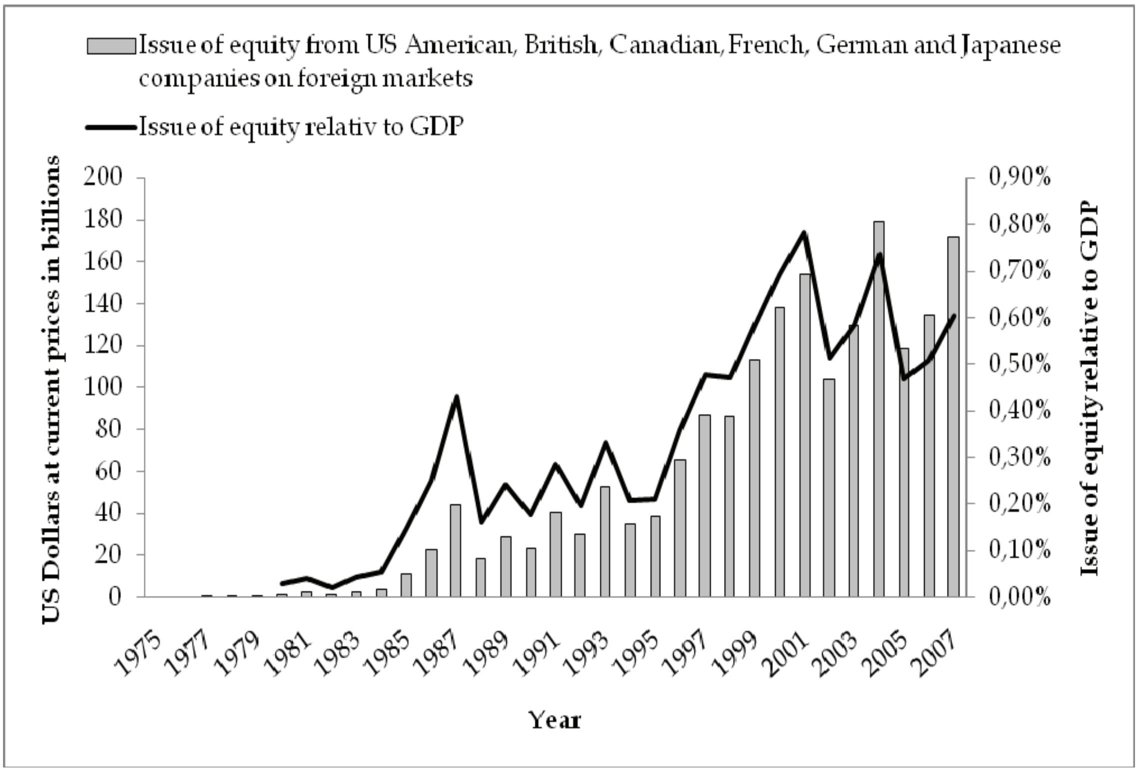
Exhibit 6: Turnover of foreign shares in million US dollar

Year	Germany	France (Euronext)	Great Britain	United States	Japan
1990	10,709	4,598	262,064	80,600	1,232
1995	13,802	3,616	626,863	341,996	1,039
2000	321,323	10,390	2,669,122	1,986,296	627
2006	253,794	19,445	3,288,102	2,507,414	1,322

Data Sources: DAI Factbook 2007; data for Canada not available

Let us now look at the company level; the supply side of financial information. 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 7 shows the total amount of equity issues and the percentage of equity issues relative to GDP from French, US, German, British, Canadian and Japanese companies on foreign markets[7] from 1975 to 2007.

Exhibit 7: Issue of equity on foreign capital markets



Data Source: Thomson One Deals, IMF World Economic Outlook Database

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

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 did 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 Dollars 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 Dollars and in 2008 the companies from the six sample countries raised 167,462 million US Dollars 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 experienced an internationalisation process during the last two decades. Companies increasingly use international markets to raise capital. Moreover, investors start 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 that focus on providing useful information for making financial decisions, while 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). Sets of information accounting rules, historically prevailing in Anglo-American countries, supposed to lower the information asymmetries more efficient than the Continental-European model. Hence, MNEs supply investors with financial reports on the basis of international accepted reporting rules, even if this is costly and time consuming—which it is in particular 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). The institutional arrangements foremost in insider countries no longer matches 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.[8] In the following section we will look closer at the economics that govern the behaviour of the mentioned actors in a globalised world: investors, companies and regulatory actors.

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 subsequent competition on global capital markets increases the demand for comparable, high quality, investor orientated accounting standards. Companies must take the claims of investors into account if they want to be successful in raising capital (Shleifer and Vishny 1986; Sikka 2001).

One major reason for companies to demand uniform accounting standards is the reduction in the cost of capital due to the worldwide application of the same accounting standards. Cost of capital can be reduced by a combined process of extending the basis of potential investors and, at the same time, reducing information asymmetries between worldwide investors and the company. Specifically, institutional investors demand transparency in financial reports to lower analysing-costs. This is achieved through enhanced comparability of available investments, lower cost for investors to collect information and a higher reliance on the presented financial data (Zimmermann and Abée 2006). Hence, 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 understanding 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

[8] 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). Hence, a full harmonisation of accounting rules might not be beneficial for all companies, e.g. smaller (non-public) companies in insider economies do not have an interest in information accounting due to their focus on private credit financing and their concentrated ownership structure (Hoarau 2009).

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[9] for companies which have to prepare two sets of consolidated accounts induce a demand for one single set of accounting standards. MNEs 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, internationally listed companies from Continental-European countries often prepared two sets of consolidated financial reports due to requirements from capital markets outside their jurisdiction. However, it is not only cross-listed companies that apply international standards. In fact, even before member states of the EU allowed or demanded financial reports on the basis of internationally accepted accounting standards, larger companies voluntarily prepared IFRS and US GAAP accounts. For example, the French industrial enterprise Saint-Gobain had already switched from local GAAP to US GAAP 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 that prepared two sets of consolidated accounts suffered higher disclosure costs, including costs for accounting personnel and auditors. Moreover, MNEs have to consolidate financial reports from subsidiary companies located in various countries, each with its own 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). Therefore, MNEs have a reasonable interest in demanding the acceptance of IFRS or US GAAP in their home countries.

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 which are more successful in raising capital (Coffee 2002). Scholars even indicate that some companies only cross-list to adapt to another regulatory regime to gain legitimacy (Zimmermann and Abée 2006). The adoption of a foreign institutional setting can be explained with the neo-institutional concept of coercive isomorphism (DiMaggio and Powell 1983): organisations mimic the structures of organisations that are in a leading position. In our context, the role models are listed companies with high market capitali-

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

sation 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). Yet, the “society” in which companies “work” has changed during the last two decades. This induces a changing institutional surrounding for companies, which necessitates adaptation.

Overall, listed companies, which compete for funds, request and use international accepted (information) accounting standards mainly for two reasons: to reduce their cost of capital and transaction costs (Jayaraman et al. 1993; Hail and Leuz 2006). From the perspective of an 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 predominant rule set. This is due to market pressure, mainly to reduce the cost of capital and the transaction costs.

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 recent decades. Moreover, the rules and the institutional setting of accounting systems are both 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), are supposed to set the most efficient, high quality accounting rules. This illustrates a second dimension of the harmonisation process: Not only the rule sets but also the organisation, meaning the institutional set-up, of accounting systems experience a pressure to harmonise.

We can differentiate between There are two triggers for governments to change the accounting regulation that can differentiated between: (1) Lobbing from firms, investors and stock exchanges and (2) the self interest from the nation-states to change the regulatory setup and thereby strengthen the national capital market and firms in the international competition to increase the 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 rules.

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 strong pressure to keep up with the prevailing developments in accounting practice. National politicians and regulatory authorities, especially from countries with a formerly under-developed capital market, experience 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.

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 (Coffee 2002). 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 the 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 therefore important actors in the process of accounting harmonisation. The *Deutsche Börse AG,* for example, already demanded financial reporting according to internationally accepted accounting standards for the segment *Neuer Markt* in 1997. The LSE allowed the issuance of annual reports on the basis of IFRS for the Alternative Investment Market (AIM) in 1995 (Fisher and Bewsey 2003). Also in 1995, the 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 of a state utilising both possibilities. With the enactment of the KapAEG the German government decided to accept consolidated accounts on the basis of internationally accepted reporting standards in 1998. Moreover, a private standard setter, the Accounting Standard Committee of Germany (ASCG), was established. The ASCG can be seen as a move towards information accounting standard setting model. The adaption of the local GAAP (*Handelsgesetzbuch*, HGB) is observable in the May 2009 enactment of the *Bilanzrechts-modernisierungsgesetz* (BilMoG) . The BilMoG modifies the HGB and brings the law closer to the IFRS, e.g. by allowing the recognition of self produced intangible assets. The German government stressed that the law strengthens the local GAAP in its competition with international reporting standards and that the law 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 of creating 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 a 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 the 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 into force in 2005 (Delvaille et al. 2005). In the UK even single accounts can be prepared on the basis of IFRS, while the UK GAAP has not been 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 SEC recently proposed a roadmap towards using IFRS for US issuers beginning in 2014. Overall it is clear that national regulators react to the global developments, but that not all governments react with the same speed, intensity or commitment.

In the environment of the globalised world, nation-states are concerned about their local markets losing competitiveness. MNEs 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 to provide the necessary resources and technical expertise to create 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, we observe a transformation of statehood in accounting regulation (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 support for a connection between globalisation and accounting harmonisation. Therefore, we rely on observing concurrent phases of increasing transnational economic activities and accounting change.[10] With the chosen method, we cannot present statistically significant causality that accounting harmonisation is driven by globalisation. However, we are able to identify that these developments correlate. 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 OECD countries.

To be able to discuss if the development of financial systems and the accounting systems might be 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), Hammermeister and Zimmermann (forthcoming 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 co-evolutionary 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 during the 1970s, when the first changes in the organisation of accounting regimes were observable. To inquire into the concurrence of globalisation and accounting harmonisation we used the following approach: We first calculated the annual globalisation

[10] 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).

growth values for each of the six sample countries (US, Great Britain, Canada, 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 averages of the annual percentage change in the FDI flows, 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.[11] 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 allowed us to identify periods in which globalisation progressed with different speed. We generated four different growth clusters for the five year time periods: no or negative growth (GR≤1), moderate growth (1<GR≤1.1), high growth (1.1<GR≤1.25) and very high growth (GR>1.25). Exhibit 8 shows the calculation of the US globalisation growth rate for the period 1995 to 1999 as an example.

Exhibit 8: Globalisation Index calculation for the US (1995-1999)

Annual Growth Rates (1.00 = no Change in Growth)	**1995**	**1996**	**1997**	**1998**	**1999**
FDI Flow	1.30	1.44	1.22	1.69	1.63
Global Cross-Border M&A	1.19	1.28	1.20	2.56	1.20
Market Capitalisation relative to GDP	1.12	1.22	1.21	1.19	1.15
Share of Foreign Equity Investors	n.a.	n.a.	n.a.	1.12	1.03
Stock Market total Value Traded relative to GDP	1.37	1.32	1.35	1.22	1.33
Globalisation Growth (unweighted average)	1.25	1.31	1.25	1.56	1.27
Geometric Mean of Globalisation Growth			**1.32**		

Source: Authors Own, Data see Section 2

We observe the highest growth rates for the periods 1985-1989, 1995-1999 and 2005-2007, in which 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, at 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 increased disclosure requirements, once 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, at 16 percent, while Germany has the lowest, at nine percent.

[11] 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.

Exhibit 9 tries to give an overview of the correlation of globalisation and accounting harmonisation, by illustrating the growth speeds and milestones in accounting harmonisation for the defined time windows. 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, 12 of which 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 (US, Great Britain and Canada) had fewer changes in their standard setting processes, disclosure laws and organisational structures during the last 40 years. The US accounting system has been by far the most stable during these 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 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 decrees 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 of or after that phase of increased globalisation: 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. While Canada decided in 2006 to use IFRS starting in 2011, the USA allowed the use of IFRS for foreign private issuers beginning in 2007 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 by 2011.

Exhibit 9: Concurrence of globalisation and accounting harmonisation

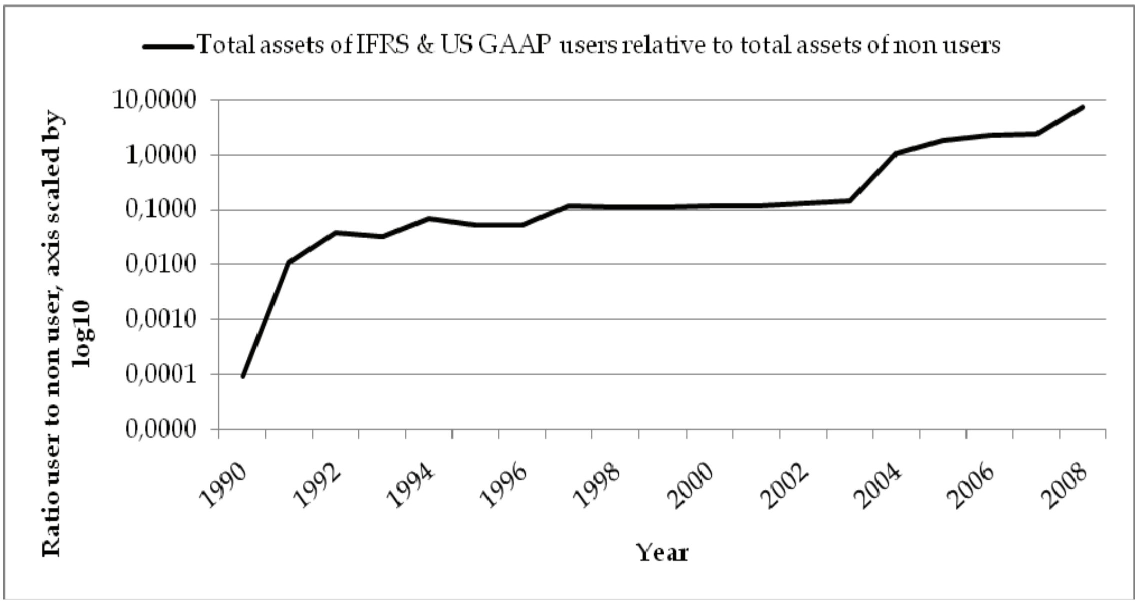
Periods	**Aggregate of sample**		**United States**		**Canada**		**United Kingdom**		**Germany**		**France**		**Japan**	
	Glob.	Acc. Harmonisation	Glob.	Acc. Harmonisation	Glob.	Acc. Harmonisation	Glob.	Acc. Harmonisation	Glob.	Acc. Harmonisation	Glob.	Acc. Harmonisation	Glob.	Acc. Harmonisation
1970-1974	+++	- First draft of Fourth EC Directive (1971) - Foundation IASC (1973)	+++	- Foundation FASB (1973)	++		+++	- ASC (1970)	+++		+++		++	- Commercial Code requires external audits (1974)
1975-1979	+	- Fourth EC Directive (1978)	++		+	- Canadian Business Corporations Act (1975)	+		o		+		+	
1980-1984	+	- Seventh EC Directive (1983)	++		o		o	- Companies Act: Implementation Fourth EC Directive (1981)	o		o	-Accounting act: Implementation Fourth EC Directive (1983)	++	
1985-1989	+++		++		++	- Joint project of the IASC and CICA (1988)	+++	- Companies Act: Implementation Seventh EC Directive; ASB & FRC (1989)	+++	- Implementation Fourth and Seventh EC Directive (1985)	+++	-Implementation Seventh EC Directive (1985)	+++	
1990-1994	o	- Comparability and Improvement Project (1993) - Advisory Council (1994)	o		+	- Accounting Standards Board (1991) - MJDS (1991) - NAFTA (1994)	o		o	- WpHG (1994)	++		o	- Amendment Commercial Code (1993)
1995-1999	++	- Endorsement of a core set of IAS by the IOSCO (1995)	+++		++		+++		+++	- KonTraG: DRSC, use of int. acc. standards (1998)	++	- Restructuring CNC (1996) - CRC (1998) - decree: use of int. acc. standards (1998)	+++	- JFSA (1998)
2000-2004	o	- Lamfalussy Report (2000) - IASB/IFRIC (2001) - EFRAG (2001) - EC 1606/2002 - Norwalk A. (2002)	o	-SOA (2002)	o	- Accounting Standards Oversight Council (2000)	o	- FSMA (2000)	o	- TransPuG (2002) - AnSVG (2004)	o	- Law on Financial Security (2003) - AMF (2003)	o	- FSAS/ASBJ (2001) - CPA law amended (2004)
2005-2007	++		++	- SEC Release NOS. 33-8879 (2007)	+++	- Decision to use IFRS from 2011 on (2006)	+++		++	- TUG (2007) - first draft BilMoG (2007)	+++		+	- Convergence project ASBJ/IASB (2005)

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 10 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 10: 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: Osiris

Voluntarily issued financial reports on the basis of US GAAP or IFRS cannot be measured before 1990; the above mentioned companies had not set a trend. It can also be argued that the globalisation had only little influence on the usage of US GAAP and IFRS until 1990. The importance of internationally 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 has 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 also noteworthy that after the issuance of Regulation 1606/2002 many firms did not 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 have voluntarily switched to international reporting standards in recent years. The ratio increased even further from 2006 through 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 grew increasingly active in 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 to not only attract local, but worldwide investors. They search for the most liquid markets to lower their cost of capital. Investors demand comparable, sets of information accounting rules to be able to discount financial numbers to calculate their expected returns. Local GAAP privileges national investors and is not able to minimize information asymmetries. Foreign investors might have difficulties understanding 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, these companies demand that national regulators accept international accounting standards. The pressure on national regulators not only arises from the lobbying by companies directly. Moreover, the liberalisation of capital flows 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 increasing a country's welfare.

Globalisation does not only put the rule sets under pressure, but also 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 not only holds for Germany and France, but is also observed in Japan, with a little time delay. As we have shown in exhibit 9 the pressure on the institutional setting is especially large at the end and after periods with high globalisation growth rates, respectively.

Overall, 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 co-evolutionary 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 by 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 and the expected further integration of capital markets will certainly support the convergence of accounting regulation.

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