# Accounting and Business Research

## International differences in IFRS policy choice: A research note

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# International differences in IFRS policy choice: a research note

**Erlend Kvaal and Christopher Nobes**[*]

**Abstract** — Building on literature that suggests motives and opportunities for national versions of IFRS practice, we examine whether there are systematic differences in IFRS accounting policies between countries. Using information from the annual reports of companies in the blue chip indices of the largest five stock markets that use IFRS, we reject a null hypothesis that IFRS practice is the same across countries. For 16 accounting policy issues, we find instead significant evidence that pre-IFRS national practice continues where this is allowed within IFRS. By this, we document the existence of national patterns of accounting within IFRS. We also point out some policy implications that arise from our findings.

**Keywords:** international standards; international differences; policy choice

## 1. Introduction

It has been suggested that there are motives and opportunities for the survival of international differences under International Financial Reporting Standards (IFRS) (Ball, 2006; Nobes, 2006; Zeff, 2007). This paper seeks to answer two questions relating to this. First, are there systematic differences between countries with respect to the accounting policies that companies use within IFRS, so that one can identify national IFRS patterns? Second, if there are, can we explain how policies were chosen on transition to IFRS?

We investigate these questions using the 2005–06 IFRS annual reports of companies based in five countries: Australia, France, Germany, Spain and the UK. In all these countries, IFRS is compulsory,[1] at least for the consolidated statements of listed companies. Strictly speaking, it is EU-endorsed IFRS[2] that is compulsory for the EU companies, and IFRS-based Australian standards that are compulsory in Australia. This point presents one of the drivers of different practices. Other opportunities for variety arise from options clearly available within IFRS, and we concentrate on

these. Given the motives and opportunities for national versions of IFRS, we expect to find such differences in practice.

This paper contributes to the literature in a number of ways. First, we document formally that there are different national versions of IFRS practice. Related to this, we show that companies not only have an opportunity to pursue pre-IFRS practices originating in their national GAAP,[3] but also extensively use this opportunity.

These findings are important for several reasons. For financial statement users, they imply that full international comparability has not yet arrived. Therefore, it has been suggested, investors might be misled by an apparent uniformity (Ball, 2006: 15). As long as accounting standards contain options and require use of judgment, some variation in accounting practice is inevitable. However, the existence of systematic differences in practice related to national borderlines is clearly in conflict with the objective of international harmonisation and may mislead financial statement users who do not pay attention to them. Some differences within IFRS practice are observable and can be adjusted for by alert analysts (e.g. the location of dividends in a cash flow statement); other differences are easily observable but cannot be adjusted for without a large degree of estimation (e.g. the effects of the

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[1] In some countries, e.g. Germany, certain companies were allowed to wait until 2007. However, no companies that took advantage of this have been included in our study.

[2] The main difference between IFRS and EU-endorsed IFRS is greater permission to use hedge accounting in the latter. There are also lags in endorsement. However, none of these differences affects our study.

[3] We use this acronym to mean 'generally accepted accounting practices', i.e. those practices that result from national requirements or from predominant choices.

inventory flow method on profit, or the absence of a gross profit figure in a by-nature income statement); yet others are not observable (e.g. the application of criteria for making impairments or for capitalising development costs). Some users of financial statements might be misled by even the first type of differences, but many might be misled by the third type. The second and third types create difficulties for international comparative analysis.

There are also policy implications. First, the IASB aims not just to issue standards but to facilitate comparable information (IASCF, 2005). This paper illustrates topics on which more work would be needed to achieve this objective. Second, the Securities and Exchange Commission (SEC) is monitoring the use of IFRS for foreign registrants on US exchanges (SEC, 2008, II, D). Part of this consideration includes an assessment of IFRS practice from 2005, but we show that there are several national versions of IFRS practice.

The paper proceeds as follows: Section 2 summarises relevant literature; Section 3 draws on this to state our main hypothesis and outline our research design; Section 4 explains our selection of countries, companies and accounting topics for this; Sections 5 and 6 present detailed hypotheses and results; and Section 7 draws interpretations and conclusions.

## 2. Literature
One strand of literature that is relevant to what follows is research on the motives and opportunities for international differences in accounting before the adoption of IFRS. This is examined in many papers and textbooks. The objective of our paper is not to try to explain pre-IFRS accounting differences. We ask, instead, whether there is evidence that country-specific variables affect choices within IFRS. To our knowledge there is no scientific literature that addresses this issue.

Nobes (2006) summarises the literature on the reasons for pre-IFRS accounting differences, asking whether these reasons might continue to operate in the context of transition to IFRS. A large number of factors has been proposed as pre-IFRS influences. The most proximate to accounting itself are legal systems, taxation systems and financing systems. These could still be relevant to IFRS practice. As examples of the three influences in turn: monitoring and enforcement of IFRS still depends on national regulatory institutions; tax motivations can still affect practice in unconsolidated statements, and some of this might flow through to consolidated statements; and companies in equity-finance coun-

tries might be the more interested in voluntary disclosures.

The national literature on IFRS is also likely to perpetuate national practices (e.g. PwC (2005) on formats).[4] Ball (2006: 15) suggests about IFRS that:

'The fundamental reason for being sceptical about uniformity of implementation in practice is that the incentives of preparers (managers) and enforcers (auditors, courts, regulators, boards, block shareholders, politicians, analysts, rating agencies, the press) remain primarily local.'

Commentators sometimes even argue in favour of attempting to preserve a national flavour of IFRS (Küting, 2007: 2557).

The international differences in accounting policies that we study mostly result from companies' policy choices, and research on this subject is potentially relevant to our work. Much of it is directed at revealing the incentives and motivations of such choices, e.g. in the context of earnings management (for comprehensive literature reviews, see Healy and Wahlen, 1999; Fields et al., 2001). These perspectives are not so important for the policy choices studied in this paper, because only a few of our issues (pension accounting, fair value option) affect the inter-period allocation of net income. Closer to our study is the research that explores the causes and effects of companies' adopting high-quality GAAP. It is often argued that companies accept the costs of such adoption in order to reduce their cost of capital (Leuz and Verrecchia, 2000; Ashbaugh and Pincus, 2001; Cuijpers and Buijink, 2005). Although there is ample evidence that voluntary adoption of IFRS has enhanced accounting quality (Barth et al., 2006; Gassen and Sellhorn, 2006), the benefits of mandatory adoption are more doubtful (Daske et al., 2007; Christensen et al., 2008). The importance of an adequate institutional framework for reporting incentives has also been emphasised (Ball, 2001; Ball et al., 2000; Bushman and Piotroski, 2006). Although this paper does not address the extent to which companies reap the rewards of IFRS reporting, the tendency to preserve national practice that we document may be one of the phenomena that limit the benefits of common reporting requirements.

There is some professional literature on IFRS practices from 2005 onwards. KPMG and von Keitz (2006) focus on 199 IFRS reports of the largest

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[4] This publication shows a financial position form of balance sheet (like Format 1 in the UK Companies Act) as an example of IFRS practice.

companies of ten countries (seven of them in the EU), using year-ends of 2005 or before. The use of those year-ends excludes the first implementation by many UK companies,[5] and also means that countries such as Australia[6] were excluded. The KPMG study reports on the choice of options, in some cases including a breakdown by country. However, that study is not designed to produce a formal comparison of practices between countries. ICAEW (2007) reports on a survey of 200 listed companies of all sizes across 24 EU countries for 2005–06. A similar report for 2006–2007 has also been published (European Commission, 2008). In general, the data in these reports on the choice of options are aggregated rather than shown by country, although there are some exceptions to that.

There is also some literature that records pre-IFRS national practices (rather than investigating motives for international differences in them) and the differences between national GAAP and IFRS. To explore this, we have consulted national laws and standards, and analyses of them, such as TRANSACC (2001). We have also looked at surveys of practice, such as FEE (1991). Differences between national rules and IFRS were analysed by Nobes (2001), whose data form the basis of a study of factors influencing the scale of these differences by Ding et al. (2007).

## 3. General hypothesis and research design

The differences in IFRS practice that we study relate to policy choices. We base our hypotheses on the literature (of the previous section) that suggests that companies tend to continue with their previous national practices where this is possible under IFRS. However, we note that there are four distinguishable reasons for this. First, as explained above, the underlying causes of previous differences between national accounting practices (such as enforcement systems) may still have scope to affect IFRS practice. Essentially, many drivers of policy choice remain national. Second, and relatedly, IFRS consolidated statements are drawn up from unconsolidated statements. So, for example, the practices required or chosen in the unconsolidated financial statements of a German parent or a German subsidiary under German law might flow through to the consolidated IFRS financial statements where the practices are permitted under IFRS. A third reason is that directors of a group might try to maintain consistent accounting policies over time,

despite the transition to IFRS, so as to create as much continuity as possible for the users of the financial statements. Fourth, and relatedly, the directors might wish to minimise the number of changes to their accounting systems, thereby reducing the company's costs of transition to IFRS, by retaining pre-IFRS practices where possible.

A potential explanation for a particular predominant pre-IFRS policy in a country might be the importance of certain sectors in that country. For example, perhaps a particular sector mostly uses first in, first out (FIFO) inventory valuation whichever country it is in, and this sector is especially strong in one country, making FIFO more than averagely common there. Our prediction is that FIFO would continue to be common in that country under IFRS. However, this might mean that the option was not being chosen in a way that reduced international comparability among similar companies. Nevertheless, as will be shown, many of the international differences are so strong that sectoral imbalances cannot explain them. For example, no German company in our sample uses only FIFO in its IFRS statements whereas half of the UK companies do.

In order to discover whether internationally different versions of IFRS practice exist, we selected large companies from five major stock markets and examined their IFRS policies for 16 issues. We propose the following null hypothesis: IFRS practice is the same across all countries. We test the null hypothesis against an alternative of non-homogeneity by chi-square tests for each topic. We further test the validity of the null hypothesis against a number of alternative hypotheses that predict national practice relating to each issue. The predictions implied in the alternative hypotheses are based on our presumption that companies, in the absence of strong incentives to do otherwise, will pursue a policy previously adopted if it is still allowed. We by no means exclude a company-specific motivation for any choices previously made under the national GAAP (see Section 2), but our focus is only on the company's behaviour on transition to IFRS.

## 4. Selection of countries, companies and policy issues

Nobes (2006) suggests a series of hypotheses about international differences under IFRS, mainly expressed by using Germany and the UK as exemplars of previously different accounting 'systems'. We study companies from these two countries, but add Australia, France and Spain. The rationale for this list of five is that, of the countries

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[5] Many UK companies do not have 31 December year-ends, so their first IFRS reports related to years ending in 2006.

[6] Australian usage of IFRS began, for most companies, on 1 July 2005.

**Table 1**
**Country and sector\* distribution**

|                          | Australia | UK | France | Spain | Germany |
|--------------------------|-----------|-----|--------|-------|---------|
| 0 Oil and gas            | 3         | 4   | 1      | 1     | 0       |
| 1 Basic materials        | 6         | 10  | 1      | 2     | 3       |
| 2 Industrials            | 5         | 6   | 7      | 8     | 3       |
| 3 Consumer goods         | 1         | 12  | 7      | 1     | 5       |
| 4 Health care            | 2         | 5   | 2      | 0     | 1       |
| 5 Consumer services      | 8         | 22  | 6      | 6     | 3       |
| 6 Telecommunications     | 1         | 3   | 1      | 1     | 1       |
| 7 Utilities              | 1         | 9   | 4      | 5     | 1       |
| 8 Financials             | 17        | 26  | 4      | 7     | 6       |
| 9 Technology             | 0         | 1   | 2      | 1     | 0       |
| Total                    | 44        | 98  | 35     | 32    | 23      |

\* Sectors according to Industry Classification Benchmark.

where IFRS are compulsory for listed companies, they had the five largest stock markets.[7]

Australia is different from the other four countries in not being a member of the EU. We do not expect that, by itself, to cause differences in IFRS practice.[8] However, one particular feature of Australian IFRS is relevant here: for two of the 16 accounting issues that we study, there was no option in Australian IFRS in 2005–2006. So, Australian policies on these issues in that period were not choices. Nevertheless, the requirements in Australian IFRS continued previous national requirements, so this is consistent with our general hypothesis that IFRS practice will preserve national practice. Further, the IFRS options were re-inserted in Australia for 2007–2008 reports onwards, so we investigate whether Australian companies continue with the 'Australian' policies on these two issues even when they are not required to.

From each of the five countries, we select the largest listed companies by examining the members of the 'blue chip' indices, respectively the ASX 50, CAC 40, DAX 30, IBEX 35 and FTSE 100. To some extent, the different number of companies in the indices adjusts for differences in the size of stock markets. We exclude foreign[9] companies and those that do not use IFRS. The only country for

which the last point was a significant issue was Germany where seven of the DAX 30 used US GAAP. After these exclusions, we have a sample of 232 IFRS reports. This is a much larger set of companies for our five countries than used by KPMG and von Keitz (2006) or by ICAEW (2007). Also, our sample is a complete set of domestic IFRS reporters in the indices, whereas the samples in the professional studies are likely to suffer from some selection bias, as already noted. Table 1 shows the sectoral distribution of the sample companies, analysed by country.

The selection of large companies is justified for both conceptual and practical reasons. Large companies are probably more attentive than smaller companies to the requirements and expectations of the global investor community (e.g. Chaplinsky and Ramchand, 2000; Wu and Kwok, 2002). Therefore, international notions about 'best practice' under IFRS will spread more rapidly among the large companies. For that reason, whenever we observe national differences in practice among the largest companies, we expect that similar differences exist among smaller firms, which are less likely to feel international influences. For the topics discussed in this paper, we can make inferences from the samples of large companies to the whole IFRS-reporting population that we could not make as easily the other way round.

As noted earlier, sectoral issues affect some accounting policies. For example, in the EU there are three different versions[10] of the Fourth Directive (for banks, insurance companies and others) which

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[7] For example, see data from the World Federation of Exchanges, as at June 2005.

[8] As explained earlier, the difference between EU-IFRS and IFRS on the subject of IAS 39 is not relevant in our study.

[9] We define 'foreign' as meaning not legally registered in the country. That is, for example, we exclude from the French sample Belgian-registered companies that prepare IFRS statements in the context of Belgian law. We exclude Rio Tinto from the Australian sample because it is also in the FTSE 100 and prepares IFRS statements in the context of UK law. We also exclude AXA Asia Pacific from the Australian sample because it is a subsidiary of AXA (France).

[10] The Directives for banks (1986) and insurance companies (1991) are derived from the fourth company law Directive 'on the annual accounts of certain types of companies' of 1978.

**Table 2**
**IFRS policy choices**

1   (a)   income statement by function
    (b)   by nature
    (c)   neither

2   (a)   inclusion of a line for EBIT or operating profit
    (b)   no such line

3   (a)   equity accounting results included in 'operating'
    (b)   immediately after
    (c)   after finance

4   (a)   balance sheet shows assets = credits
    (b)   showing net assets

5   (a)   liquidity decreasing in balance sheet (cash at top)
    (b)   liquidity increasing

6   (a)   Statement of Changes in Equity, including dividends and share issues
    (b)   SORIE, not including them

7   (a)   direct operating cash flows
    (b)   indirect

8   (a)   dividends received shown as operating cash flow
    (b)   as investing

9   (a)   interest paid shown as operating cash flow
    (b)   as financing

10  (a)   only cost for PPE
    (b)   some fair value

11  (a)   investment property at cost
    (b)   at fair value

12  (a)   some designation of financial assets at fair value
    (b)   none

13  (a)   capitalisation of interest on construction
    (b)   expensing

14  (a)   FIFO for inventory cost
    (b)   weighted average

15  (a)   actuarial gains and losses to SORIE
    (b)   to income in full
    (c)   corridor

16  (a)   proportional consolidation of some joint ventures
    (b)   only equity method

contain pre-IFRS requirements on many presentation and policy issues. For such (and other) reasons, many empirical studies exclude banks and other financial institutions. As a result, these companies are under-researched. We include them. However, for several of the policy issues that we study, it is obviously appropriate to treat the banks or financial institutions separately.

We examine the annual reports for 2005–2006, that is those relating to accounting years starting in

2005. Many of these years begin on 1 January, but some UK companies have chosen other dates (especially 1 April), and many Australian companies use 1 July. The 2005–2006 reports were the first for which IFRS was compulsory[11] in our five countries, and they were also the last full set available[12] when we collected our data. All the companies were subject to the same requirements, as there were no changes to IFRS in this period.

Nobes (2006) identifies eight types of opportunity for international variations in IFRS practice: different versions of IFRS; different translations of IFRS; gaps in IFRS; overt options; covert options; measurement estimations; transitional issues; and imperfect enforcement. For several of these, detailed lists are provided: e.g. 18 overt options, 21 covert options. From these lists, we identified all the issues[13] for which data are observable in published annual reports. The resulting 16 issues of accounting policy are shown as Table 2. Nine of these relate to presentation and seven to measurement. Of the presentation issues, some are cosmetic (such as issues 4, 5 and 6), whereas others (such as issues 2, 3, 8 and 9) directly affect the content of key items within the income and cash flow statements. For our purpose, it is important to collect all the available information on international differences in IFRS policies. This is because on some other major issues, e.g. the criteria for assessing impairments (Ball, 2006: 17), it is not possible to detect and measure differences. The more that we can demonstrate systematic international differences for issues that can be observed (however important or otherwise), the more we can be confident that there will be differences for important issues that cannot be observed.

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[11] Of our five countries, only Germany contained companies voluntarily using IFRS immediately prior to 2005. A majority of our sample of German companies used IFRS before 2005. However, we do not anticipate that this would affect policy choices except where new options were introduced in 2005 or shortly before. In our list of policy areas, the only new option was to take actuarial gains and losses to the SORIE, introduced in 2005. It is therefore possible that this recent option was more likely to be ignored by German companies. However, this is still a country-specific factor.
[12] For example, reports for years ending in November 2007 were not available until well into 2008. We collected data during the second half of 2007.
[13] The 16 issues are all 'overt options'. We excluded six issues from Table 1 of Nobes (2006) because they related to unconsolidated statements (the options in IASs 27, 28 and 31 concerning investor statements) or to rare issues on which little or no data was available (commodity broker traders (IAS 2), government grants (IAS 20) and revaluation of intangibles (IAS 38)). Similarly, it is not possible to gauge the use of 'covert options' by using published annual reports. However, a few of the overt options in Nobes (2006) cover several issues (e.g. the treatments of interest and dividends in cash flow statements). So we have separated them.

Our policy issues are not, of course, a random selection. They are deliberately chosen as those for which IFRS offers a choice and for which the chosen policy is observable. We are not claiming that the adoption of IFRS has led to no standardisation of practice. We are investigating whether there remain substantial systematic international differences in practice even under IFRS.

The data relating to the 16 accounting policy issues of Table 2 are not available on any database and were hand-picked from the annual reports[14] for the 232 companies in our sample. For many of the issues, a full set of data was obtained. For a few issues no data were available for some companies,[15] because the issue did not apply or because of poor disclosure.

## 5. Hypotheses

As explained in Section 3 we have a general null hypothesis of similar IFRS practice across countries that we analyse by a chi-square test. In addition, we make pair-wise comparisons between countries on all of the 16 issues covered by our study. The hypotheses underlying these comparisons are explained below. Our expectation is that pre-IFRS national practices will continue. We briefly review these practices and then set out our predictions for the 16 issues of Table 2. In nearly all of our hypotheses below, the pre-IFRS practices that we refer to result from national requirements. We assume that practices conformed with requirements (especially for these easily visible practices of listed companies, which were all audited by Big Four audit firms). In three cases (issue 13 for Spain, and issues 4 and 14 for the UK), we refer to predominant pre-IFRS practice. Strictly speaking, we should refer, company by company, to the actual pre-IFRS practices. So, in Section 6, we do ask whether particular companies continued with their pre-IFRS policies, but that detailed approach is not necessary for the general prediction of the IFRS practices of companies.

1. *Presentation of income statements (non-financials)*. The Spanish law of 1989 sets out a by-nature format for the income statement. By contrast, the pre-IFRS rules in all the other countries allowed by-nature or by-function. We therefore predict for IFRS practice that:

**H1:** Spanish companies are more inclined than

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[14] We used the English language reports in all cases, but we do not expect that this would affect our data.
[15] See the 'N' numbers in Table 3.

others to use the by-nature format of the income statement.

This is an important issue for analysis because it is not possible for users to obtain the same information[16] from the two different formats.

2. *Operating profit shown (non-financials)*. Pre-IFRS national regulations on formats differ on whether a sub-total for 'operating profit' should be shown. There is such a line in the French *plan comptable général* (section I.III.III) and in the Spanish plan derived from it. Similarly, the formats found in the German *Handelsgesetzbuch* (HGB § 275) and the UK Companies Act[17] show operating items (specifically thus labelled) separately from others, although without specifically showing the subtotal. By contrast, there were no such headings or subtotals in Australia in ASRB 1018 (para. 4.1).

We therefore predict:

**H2:** Australian companies are less likely than other companies to show a line for operating profit.

3. *Treatment of equity-accounted profits (non-financials)*. IAS 1 has few format requirements for the income statement. However, its non-mandatory implementation guidance shows equity-accounted profit after finance costs and therefore outside of operating profit. The same applies to the French *plan comptable général* (Appendix to Chapter IV) and the related Spanish requirements. By contrast, the German HGB (§ 275) and the UK standard (FRS 9) show such profits after operating but before finance items. There has been no clear tradition in Australia. Many Australian companies do not show an 'operating' heading (see 2 above). Pre-IFRS guidance from AASB 1018 (para. 4.1) showed equity-accounted profits after finance costs, as do IFRS illustrations[18] from Australian audit firms.

Given that the French and Spanish national requirements show equity-accounted profits lower down the income statement than in the other countries which have a concept of 'operating', and given that only in those countries are the requirements mandatory (for non-IFRS reporting), we predict:

**H3:** French and Spanish companies are more inclined than others to show equity-accounted profits after finance items.

4. *Presentation of balance sheets (non-financials)*. The pre-IFRS requirement in Australia was in the Corporations Law (and AASB 1034) which specified a format that showed 'net assets' but no total of credit balances such as total shareholders' funds and liabilities. The same applied in Format 1 of the UK *Companies Act 1985* (CA 1985), which also showed 'net current assets' and did not show total assets. This was the predominant format used in practice (Gordon and Gray, 1994: 76; and our own survey of pre-IFRS policies of our companies, discussed later). These can be called 'financial position' formats, although the UK's was a purer form.

By contrast, the accounting plans of France and Spain showed a two-sided T-account format, and the German *Handelsgesetzbuch* (HGB § 266) had a vertical version of this. In all three continental cases, there is no heading for 'net assets' but there is a heading for the total of the credit balances.

We therefore predict:

**H4:** Australian and UK companies are more inclined than others to use a version of a financial position format.

5. *Liquidity order (non-financials)*. The pre-IFRS regulations for balance sheets (referred to above) show items in order of decreasing liquidity in Australia but (except for banks) increasing liquidity in the other four countries. Therefore, we predict:

**H5:** Australian companies are more inclined than others to present liquidity-decreasing balance sheets.

6. *Statement of changes in equity*. Only in the UK did pre-IFRS rules (FRS 3) require a performance statement in addition to the income statement. This UK statement was the model for IAS 1's statement of recognised income and expense (SORIE) – equivalent to the 'other comprehensive income' of a later version of IAS 1– as opposed to the alternative statement of changes in equity of IAS 1 (para. 97).[19] So, we predict:

**H6:** UK companies are more inclined than others to present a SORIE.

7. *Method of calculation of operating cash flow.* Pre-IFRS rules on cash flow statements were

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[16] For example, gross profit cannot be calculated from the by-nature format.

[17] Schedule 4 to CA 1985, now replaced by 'Company Regulations' in Statutory Instruments.

[18] For example, KPMG's *Reporting Under Australian Accounting Standards*, Example Public Company Limited (for 2007), p. 21; and PwC's *Value AIFRS Holdings*, p. 63.

[19] We refer to the version of IAS 1 in force in 2005 and 2006.

lacking in detail in Germany and were noticeably different from IAS 7 in France, Spain and the UK. However, only in Australia was the direct method required (AASB 1026) and this found its way into the Australian version[20] of IAS 7 that was in force in 2005–2006. However, IAS 7's choice of the indirect method was re-inserted into the version in force in 2007–2008, so we used data for that period for the Australian companies (typically periods ending on 30 June 2008). Given that the direct method is more onerous for preparers, we predict a continued[21] avoidance of it elsewhere:

**H7:** Australian companies are more inclined than others to use the direct method to calculate operating cash flows.

8/9. *Presentation of dividends received and interest paid in cash flow statements (non-financials).* IAS 7 (para. 33) suggests that dividends received might be either operating or investing flows and that interest paid might be either operating or financing, except that financial companies 'usually' treat them both as operating. In the UK, FRS 1 (para. 14) requires both dividends received[22] and interest paid to be shown as 'returns on investments and servicing of finance'. In Australia, AASB 1026 (para. 7.1) required both cash flows to be shown as operating. The French requirement[23] for consolidated statements is also to show both dividends received and interest paid as operating. There is no requirement for a cash flow statement in Spain; rather the law[24] requires a statement of sources and applications of funds. In Germany, cash flow statements are required for listed companies (from 1999 onwards) but the pre-IFRS rules lack detail.

There is therefore no clear national practice for Germany or Spain, but we can predict:

**H8:** UK companies are less likely than Australian or French ones to show dividends received as operating.
**H9:** UK companies are less likely than Australian or French ones to show interest paid as operating.

10. *Use of fair value to measure property, plant and equipment* (PPE). Pre-IFRS requirements in France, Germany and Spain were to base measurement on

historical cost except for occasional revaluations in France and Spain according to government regulations (TRANSACC, 2001: 1162, 2263). Only in Australia (AASB 1041) and the UK (FRS 15) was revaluation freely allowed. We predict:

**H10:** Australian and UK companies are more inclined than others to measure PPE at fair value.

11. *Use of fair value to measure investment property.* As for other PPE (above), pre-IFRS requirements in France, Germany and Spain were generally to measure investment property on a cost basis. However, as for other PPE, there was an option to use fair value in Australia. By contrast, continuous valuation[25] is required under UK GAAP by SSAP 19. We therefore predict:

**H11:** The tendency to measure investment property at fair value will be found in decreasing order in the UK, Australia and continental Europe.

12. *Designation of financial assets to fair value (non-financials).* Pre-IFRS requirements concerning the measurement of financial assets by non-financial companies differed by country. German law required measurement at cost or lower for all assets (HGB § 253). French and Spanish accounting laws were less resolutely opposed to measurement above cost,[26] so we use Germany in the hypothesis below. UK law allowed various versions of market value (CA 1985, Sch. 4, para. 31). UK standards and Australian law and standards had no requirements in this area. We therefore predict for non-financial companies:

**H12:** Australian and UK companies are more inclined than German companies to designate financial assets to fair value.

Financial institutions had different laws (for example, different Directives; see Section 4 and Hypothesis 5) allowing marking to market. We do not test hypotheses for financial institutions because of the small number of such companies in our sample of continental countries.

13. *Interest capitalisation.* The pre-IFRS requirement in Australia was to capitalise interest (AASB 1036). In Spain, the ICAC Resolution of 30 July 1991 deals with the issue in some detail, and it was

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[20] That ruling in 2005–2006.
[21] For example, all our UK companies used the indirect method under UK GAAP in 2004–2005; see discussion later.
[22] Except that dividends received from associates and joint ventures are shown separately, also outside of operating.
[23] Second Methodology, § 426.
[24] Law 19/1989.

[25] SSAP 19 (para. 11) requires measurement at 'open market value' which is similar to fair value.
[26] For example, revaluations of various assets were required for listed companies in France in 1978 and in Spain in 1996.

almost universal pre-IFRS practice of our companies.[27] By contrast, in the other three countries, capitalisation of interest was allowed[28] but was not covered in detail in the regulations and was less common.[29] We predict:

**H13:** Australian and Spanish companies are more inclined than others to capitalise borrowing costs on construction.

14. *Inventory flow assumptions (non-financials)*. Excluding consideration of last in, first out (LIFO) (which is not allowed in IAS 2), the UK and Germany stand out as having predominant flow assumptions in pre-IFRS national practice. In the UK, FIFO was the normal practice (FEE, 1991: 164; as also confirmed in our own survey of pre-IFRS policies). In Germany, weighted average was generally required by tax law (TRANSACC, 2001: 1293). In Spain, although there was no legal favouring of weighted average, there was also evidence of a clear pre-IFRS preference for it (FEE, 1991: 167; Gonzalo and Gallizo, 1992: 114). In the other two countries, no predominant basis was clear. We therefore predict:

**H14A:** German companies are more inclined than others (except Spanish) to use weighted average only.

**H14B:** UK companies are more inclined than others to use FIFO only.

15. *Actuarial gains and losses*. Most German DAX companies were already using IFRS before 2005 when an extra option was added to IAS 19 (para. 93A) to allow actuarial gains and losses to be taken in full to the SORIE. Therefore, they were already using the corridor approach (IAS 19.92/93). By contrast, the pre-IFRS requirement in the UK (under FRS 17) was the same as the SORIE option. Neither of these options was available in the laws of the other three countries. So, we predict:

**H15A:** German companies are more inclined than others to use the corridor approach.

**H15B:** UK companies are more inclined than others to use the SORIE approach.

16. *Proportional consolidation*. Pre-IFRS rules in Australia (AASB 1006) and the UK (FRS 9) did not allow proportional consolidation of interests in joint venture entities. By contrast, pre-IFRS French regulations required proportional consolidation (*Loi sur les Sociétés Commerciales*, Art. 357-3). In Spain, the method was required[30] in some industries and common in others (Gonzalo and Gallizo, 1992: 168). In Germany, proportional consolidation was allowed and used by some groups (TRANSACC, 2001: 1389). However, it was not typical practice, as it had been banned in Germany until 1987. We, therefore, predict:

**H16:** The tendency to use proportional consolidation is found in the following countries in decreasing order: France, Spain, Germany, UK and Australia.

As in policy issue 7 above, there is a complication with the data for Australia. In the Australian 2005–2006 version of IFRS (i.e. AASB 131 in this case), the proportional option in IAS 31.30 was deleted. So we cannot measure policy *choice* for 2005–2006. However, the option was re-inserted for 2007–2008, so we use data for that period.

## 6. Results

### 6.1. Tests of hypotheses

Table 3 shows the results of testing the above hypotheses. First, it summarises the data collected for the five countries relating to all the issues of Table 2. For each country and issue, the table shows the policies used, as percentages of the companies for which the policy was observable (see the 'N'). In most cases, the data can be reduced to the percentages using one policy out of two available in IFRS, although in a few cases (e.g. issue 3) we record the scores for three possibilities.

As explained earlier, we conduct two sorts of statistical tests on these data. The chi-square test measures the overall independence between policy choice and country for each of the 16 issues. The null hypothesis of similar practice is rejected at the 1% level for 14 issues and at the 5% level for two of them.

Table 3 also shows the results of the binomial tests. The testing of issues that have two choices is carried out with conventional methods of approximations to the normal distribution. In practice we do the same tests for the issues that have more than two choices, by formulating the hypothesis with respect

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[27] We surveyed the 2004 annual reports for the companies that specified their practice in 2005. Of the 17 companies, 16 capitalised interest, and one company capitalised some interest.

[28] For example, by AktG § 255(3) in Germany, or CA 1985, Sch. 4, para. 26(3)(b) in the UK.

[29] For example, our survey of UK reports of 2004–2005 showed that 35% of companies disclosed a policy of capitalisation. Only 13% disclosed a policy of non-capitalisation, but our expectation is that this would have been the policy of the non-disclosers.

[30] At least, information on a proportional basis had to be included in the balance sheet for joint ventures in the construction industry (TRANSACC, 2001: 2314).

**Table 3**
**Policy choices (percentages of companies by country) and hypothesis testing**

| | Policy choices by country, % | | | | | $\chi^2$ tests[a] | | Alt. | Binomial tests[b] | H0 reject. |
|---|---|---|---|---|---|---|---|---|---|---|
| | Australia | UK | France | Spain | Germany | P-value | Cramer conting. coeff | hypothesis | Hypothesis testing (pair-wise) | (level) |
| 1a) income statement by function | 59.3 | 47.2 | 54.8 | 4.0 | 76.5 | .000 | .242 | H1 | Sp vs. Au, UK, Fr and Ge | .01 |
| 1b) by nature | 29.6 | 13.9 | 45.2 | 96.0 | 23.5 | | | | | |
| 1c) neither | 11.1 | 38.9 | 0.0 | 0.0 | 0.0 | | | | | |
| N (= non-financials) | 27 | 72 | 31 | 25 | 17 | | | | | |
| 2a) inclusion of a line for EBIT or op profit | 51.9 | 97.2 | 100.0 | 96.0 | 100.0 | .000 | .335 | H2 | Au vs. UK, Fr, Sp and Ge | .01 |
| N (= non-financials) | 27 | 72 | 31 | 25 | 17 | | | | | |
| 3a) equity acc included in operating | 63.2 | 24.5 | 6.9 | 0.0 | 18.8 | .000 | .230 | H3 | Fr vs Au, UK and Ge | .01 |
| 3b) immediately below | 15.8 | 32.1 | 3.4 | 8.3 | 62.5 | | | | Sp vs Au, UK and Ge | .01 |
| 3c) below finance | 21.1 | 43.4 | 89.7 | 91.7 | 18.8 | | | | | |
| N (= non-financials with equity accounting) | 19 | 53 | 29 | 24 | 16 | | | | | |
| 4b) showing net assets | 100.0 | 84.7 | 0.0 | 0.0 | 0.0 | .000 | .783 | H4 | Au vs. Fr, Sp and Ge | .01 |
| | | | | | | | | | UK vs. Fr, Sp and Ge | .01 |
| N (= non-financials) | 27 | 72 | 31 | 25 | 17 | | | | | |
| 5b) liquidity increasing | 0.0 | 100.0 | 100.0 | 96.3 | 85.0 | .000 | .893 | H5 | Au vs. UK, Fr, Sp and Ge | .01 |
| N (= non-banks) | 37 | 90 | 32 | 27 | 20 | | | | | |
| 6b) SORIE only | 65.9 | 83.7 | 5.7 | 25.0 | 21.7 | .000 | .391 | H6 | UK vs. Au, Fr, Sp and Ge | .01 |
| N (= all) | 44 | 98 | 35 | 32 | 23 | | | | | |
| 7b) indirect cash flows | 0.0 | 98.0 | 100.0 | 87.5 | 100.0 | .000 | .785 | H7 | Au vs. UK, Fr, Sp and Ge | .01 |
| N (= all) | 44 | 98 | 35 | 32 | 23 | | | | | |
| 8a) dividends received as operating | 87.5 | 36.7 | 92.9 | 50.0 | 66.7 | .000 | .265 | H8 | UK vs Au and Fr | .01 |
| N (= companies showing dividends) | 40 | 60 | 28 | 18 | 6 | | | | | |
| 9a) interest paid as operating | 90.9 | 68.4 | 88.6 | 38.7 | 61.9 | .000 | .134 | H9 | UK vs Au and Fr | .01 |
| N (= companies showing interest paid) | 44 | 98 | 35 | 31 | 21 | | | | | |
| 10b) some PPE at fair value | 13.6 | 12.2 | 0.0 | 0.0 | 0.0 | .014 | .054 | H10 | Au vs. Fr, Sp and Ge | .05 |
| | | | | | | | | | UK vs. Fr, Sp and Ge | .05 |
| N (= all) | 44 | 98 | 35 | 32 | 23 | | | | UK vs. Au | .05 |
| 11b) some investment property at fair value | 42.9 | 73.1 | 0.0 | 0.0 | 0.0 | .000 | .411 | H11 | UK vs. Fr, Sp and Ge | .01 |
| | | | | | | | | | Au vs.Sp and Ge | .01 |
| N (= companies with investment properties) | 28 | 26 | 7 | 14 | 15 | | | | Au vs. Fr | .05 |
| 12a) some fair value designation | 29.6 | 12.5 | 32.3 | 12.0 | 5.9 | .033 | .061 | H12 | Au vs. Ge | .05 |
| N (= non-financials) | 27 | 72 | 31 | 25 | 17 | | | | UK vs. Ge | NR |

**Table 3**
**Policy choices (percentages of companies by country) and hypothesis testing** (*continued*)

| | Policy choices by country, % | | | | | $\chi^2$ tests[a] | | Alt. hypothesis | Binomial tests[b] | H0 reject. (level) |
|---|---|---|---|---|---|---|---|---|---|---|
| | Australia | UK | France | Spain | Germany | P-value | Cramer conting. coeff | | Hypothesis testing (pair-wise) | |
| 13a) interest capitalisation | 75.8 | 47.5 | 40.0 | 94.4 | 22.2 | .000 | .186 | H13 | Au vs. UK, Fr and Ge | .01 |
| N (= companies specifying borrow. costs) | 33 | 59 | 25 | 18 | 18 | | | | Sp vs. UK, Fr and Ge | .01 |
| 14a) FIFO only | 27.3 | 50.0 | 11.5 | 5.9 | 0.0 | .000 | .129 | H14A | Ge vs. UK | .01 |
| 14b) weighted average only | 59.1 | 29.2 | 57.7 | 88.2 | 71.4 | | | | Ge vs. Au and Fr | NR |
| N (= companies with inventory) | 22 | 49 | 26 | 17 | 14 | | | H14B | UK vs. Fr, Sp and Ge | .01 |
| | | | | | | | | | UK vs. Au | .05 |
| 15a) actuarial gains/losses to SORIE | 72.7 | 84.4 | 20.0 | 12.5 | 47.6 | .000 | .235 | H15A | Ge vs. Au and UK | .01 |
| 15b) to income in full | 18.2 | 3.3 | 5.7 | 37.5 | 0.0 | | | | Ge vs. Fr and Sp | NR |
| 15c) corridor | 9.1 | 12.2 | 74.3 | 50.0 | 52.4 | | | H15B | UK vs. Au | NR |
| N (= companies with defined benefit plans) | 33 | 90 | 35 | 16 | 21 | | | | UK vs. Fr, Sp and Ge | .01 |
| 16a) some proportional consolidation | 5.3 | 22.4 | 81.3 | 84.6 | 31.3 | .000 | .381 | H16 | Fr vs. Au, UK and Ge | .01 |
| N (= companies with joint venture entities) | 19 | 67 | 32 | 26 | 16 | | | | Fr vs. Sp | NR |
| | | | | | | | | | Sp vs. Au, UK and Ge | .01 |
| | | | | | | | | | Ge vs. Au | .05 |
| | | | | | | | | | Ge vs. UK | NR |
| | | | | | | | | | UK vs. Au | .05 |

[a] The $\chi^2$-test measures the independence of the cells of a contingency table with accounting choice cross-tabulated with country. The Cramér's contingency coefficient defined as $\chi^2/N(q-1)$, where $q$ is the number of alternative choices, measures the strength of the association (cf. Bhattcharyya and Johnson, 1977: 434).
[b] The rejection level of the binomial tests refers to all the pair-wise tests included in that row. NR means no rejection.

**Table 4**
**Deviations per company from pre-IFRS national requirements**

|                                        | *Australia* | *UK* | *France* | *Spain* | *Germany* |
|----------------------------------------|-------------|------|----------|---------|-----------|
| N (= non-financials)                   | 27          | 72   | 31       | 25      | 17        |
| 1. Average number of deviations        | 1.04        | 1.72 | 0.48     | 0.20    | 0.35      |
| 2. Maximum possible deviations         | 8           | 9    | 9        | 7       | 7         |
| 3. Average as percentage of maximum    | 13.0        | 19.0 | 5.4      | 2.9     | 5.0       |

to one specific alternative. It follows from the idea underlying the alternative hypotheses that, for testing purposes, the sample of companies from each country should be treated as separate populations. When, for example, it is claimed that Spanish companies are more inclined than others to present an income statement by nature, the related testing consists of pair-wise comparisons between the scores of the Spanish sample and the scores of each of the other samples, i.e. a total of four tests. If we had been certain that the null hypothesis were true for all companies except Spanish ones, we might, of course, have pooled the scores of the latter four for the purpose of the testing. However, whether the statistical distributions are identical or not is precisely the question we seek to answer, and the consequence is that all samples are treated separately. As we have designed the statistical analysis, each of the four tests should result in a non-rejection of the null hypothesis if it is true.

One problem that we encounter by this pair-wise approach is that some of the samples compared are under the threshold recommended for approximations to the normal distribution (typically 25, see for example, Bhattacharyya and Johnson, 1977: 295). In this study each single test is not essential for the conclusion, so we report all results, being aware that some of them may be based on insufficient sample sizes.

Thus, hypothesis H1, which proposes that Spanish companies have a greater tendency than others to use an income statement by nature, was tested pair-wise for each of the other four countries. In all four cases, the null hypothesis that Spanish choices are the same as others is rejected at the 1% level.

We ran 82 binomial tests. Of these, 62 led to the rejection of the null hypotheses at the 1% level, and a further 12 tests did so at the 5% level. The remaining eight tests did not enable rejection of the null hypotheses but in six of these cases the data were consistent with our alternative hypotheses.

In sum, there is a large amount of highly significant evidence that policy choice under IFRS varies internationally and is not random.

Furthermore, we have shown that the national profile of IFRS practice is explained by national pre-IFRS requirements (or predominant practice).

### 6.2. Comparisons with pre-IFRS practices

The above hypotheses largely concern the continuation of policies previously required by national GAAP. The only cases where we relied on predominant national choices for our hypotheses related to Spain (issue 13) and the UK (issues 4 and 14). A more precise hypothesis is that a particular company continued with its particular pre-IFRS policy choice. To test this, we looked at all the 2004–05 (pre-IFRS) reports of our Spanish and UK companies for these issues. For issue 13 (capitalisation of interest), 94% of Spanish companies[31] maintained their pre-IFRS practice of capitalisation. For issue 14 (FIFO, weighted average or a mixture), all 69[32] UK non-financial companies made exactly the same policy choice under IFRS as they had done pre-IFRS. For issue 4 (balance sheet format), 88% of the UK companies maintained their policies.[33]

On the assumption (defended earlier) that, pre-IFRS, our companies complied with national requirements, Table 4 shows the policy switches under IFRS. As can be seen, there are few such switches (e.g. less than 3% of policies were switched by Spanish companies). If we add in the other policy issues for which there was no national requirement, by studying the pre-IFRS practices of the particular companies, we find similar results.[34]

### 7. Conclusions

The central objective[35] of the IASB is to foster the provision of comparable financial information for participants in the world's capital markets. This

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[31] Seventeen companies disclosed a policy for both years.
[32] There were 72 non-financial companies in our UK data, but three of them did not publish UK GAAP reports for 2004–2005.
[33] Of the 69 companies, seven changed from showing net assets to not doing so, and one changed the other way.
[34] For example, for the UK, we add six more issues, and find 18.8% switches for all 15 issues. We omit issue 12 because there was no pre-IFRS requirement or practice on designation.
[35] IASB's *Preface to International Financial Reporting Standards*, para. 6.

would be achieved if similar transactions were measured and presented similarly throughout the markets, i.e. uniform practice. The existence of systematic differences in accounting policies due to non-economic characteristics – such as country of incorporation – is clearly contrary to this ambition.

This paper highlights 16 accounting issues for which the literature identifies international differences in pre-IFRS reporting, and for which variation within IFRS is allowed and is observable if it occurs. An examination of the policies used by all the domestic IFRS reporters in the stock indices of five major capital markets for the first year of compulsory IFRS adoption allows us confidently to conclude that IFRS practice is subject to systematic differences across countries.

The continuation of national traditions seems to explain variations in IFRS policies between countries. However, that is merely a proxy for our more precise hypothesis that a particular company continued with its pre-IFRS policies on transition to IFRS. For each non-financial company of the five countries, we compare its practice under IFRS with pre-IFRS requirements and find that there were few deviations from those earlier requirements. When we extend this to look at policy switches even where there was no pre-IFRS requirement, we again confirm the preservation of previous practices.

Our research shows that systematic differences exist both in trivial matters (such as the liquidity order of the balance sheet) and in more complex matters (such as the composition of cash flows from operations or the treatment of actuarial losses). Whereas the former are hardly any obstacle to comparability, the latter most likely are. Some of our policy issues are not as important as others but they bolster the evidence for the existence of national versions of IFRS practice. This allows strong inferences to be made about variation in practices that cannot easily be measured, e.g. the tendency to make impairments.

We believe that our results are extensible in various ways. First, we examined very large listed companies. These are probably the least likely to evince national practices. We expect that test results would be at least as strong for other companies, but this can be examined. Second, our choice of blue chip companies limited the size of the sample, especially for Germany. We do not expect that a larger sample would change our results, except to make them even stronger, but it would enable an extended analysis of whether a company's sector affects its policy choices. This would add to our findings of some differences between financial and non-financial companies. Third, we examined 16

areas of policy choice. There are many others which are less observable. For example, there are several covert options and estimations in the issue of impairment, such as whether to recognise impairments, how to measure cash flows, and what discount rate to use. National traditions (and, specifically, previous practices of companies) are likely to continue in some of these areas. It is not clear how to examine these covert options, but other researchers might try. Fourth, we examined five countries, but would expect national versions of IFRS to be observable in smaller IFRS-using capital markets. Fifth, we concentrated[36] on one year's worth of annual reports; mostly[37] the first year of IFRS adoption. Later research could address whether companies gradually exploit options more fully, at least up to reports published in 2010 when some[38] IFRS options will no longer be available. To the extent that we look at data after 2005–2006 (for 2007–2008 for two Australian issues), we find national practice continuing.

The five points above are limitations of our research. A more general limitation is that, although we can largely explain why particular companies adopted particular IFRS policies in the context of the transition to IFRS, more work is needed to go deeper into why, over a long period, particular policies have been preferred in particular countries or by particular companies. For some issues (e.g. the German preference against measurement above cost), the literature is extensive. For others, 'accidents' are the apparent cause (such as the German use of the 'corridor' pensions method because German companies adopted IFRS before other countries did, when the 'SORIE' method was not available). For yet other issues (e.g. why the Spanish prefer to capitalise interest), there is no convincing theory. It might be necessary to theorise about each policy choice, one by one, such that no overall theoretical model would be explanatory.

We remind readers of other caveats. First, for most of our hypotheses, we assume that, pre-IFRS, national requirements were followed. We believe that this is highly likely to be a correct assumption for our large listed companies for our easily observable policy choices. However, there might be some exceptions. Second, for two of the policy issues for Australia, companies had no choice in

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[36] Although, we examined 2008 reports for two Australian issues.

[37] Except for the German companies.

[38] Of our 16 issues, the presentation of the income statement, the capitalisation of interest, and perhaps the treatment of joint ventures will be affected, but not compulsorily until 2009 year-ends or later.

2005–2006. Although this does not alter our findings about the continuation of pre-IFRS practices, these are different cases from all the other countries and all the other issues. Nevertheless, by substituting data for 2007–2008 (when there was a choice), we can rectify that. This time, we need to assume that a company would have chosen in 2005–2006, what it chose in 2007–2008. We know of no reason to doubt that.

In addition to the possible extensions to our research resulting from the limitations mentioned above, another opportunity is to examine whether a two-class model (Anglo-Saxon versus Continental European) that was discussed[39] before the adoption of IFRS exists under IFRS. That is, for example, do Australian and UK companies tend to choose IFRS options in the same way (and perhaps in conformity with US GAAP), at least compared to continental European companies? A further possibility is to ask why certain companies deviate from pre-IFRS practices and national profiles, and why this is more common for UK companies than for Spanish ones (see Table 4).

Another issue to be investigated is whether market participants are able to see through the different policy choices. If it turns out that they can, then the differences are less important for users and regulators. However, investigations in this area are complex, and previous studies (e.g. on LIFO adoption) are both numerous and inconclusive.

There are policy implications from our findings. We believe that options in accounting standards are justified to the extent that they enable companies with different economic characteristics to produce a fair presentation of their activities. The systematic differences in practice between countries, that we document in this paper, are an unwanted corollary. In our view the disadvantages of systematic differences outweigh the advantages of having options, so we encourage the IASB to continue its efforts to remove options. Second, analysts of financial statements should be alert to the continuing international differences within ostensibly 'international' standards. Analysts might benefit from knowing the national profiles when trying to construct comparable figures. For example, it might be helpful to know that French IFRS companies tend to proportionally consolidate the cash of joint ventures, to show interest paid as an operating cash flow and to charge actuarial losses as expense, whereas UK IFRS companies tend not to do those things. It might also be helpful to know that

other, potentially more important, country-related differences (e.g. on impairment) exist beneath the surface of IFRS practice. Third, this variation in IFRS practice is likely to be of interest to regulators, especially to the SEC as it monitors IFRS practice of foreign registrants and perhaps, in future, of US companies. The SEC's acceptance of IFRS has been made on the assumption[40] of further progress in removing options.

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[39] See, for example, the disagreement between d'Arcy (2001) and Nobes (2004).

[40] SEC, 2008, II, B.

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