

**Why did(n't) the accountant cross the road?
Towards a model of European enforcement of
International Financial Reporting Standards**

Sally Aisbitt

July 2004

04/04

ISBN 0 7492 0140 1

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Dr Sally Aisbitt, Senior Lecturer in Accountancy, Open University Business School,
Walton Hall, Milton Keynes, MK7 6AA

Email: S.A.Aisbitt@open.ac.uk

Tel: 01908 659057

Fax: 01908 655898

Acknowledgements

The author is grateful for helpful comments on an earlier version of this paper from participants at the 26th Annual Congress of the European Accounting Association in Seville, Spain, 2-4 April 2003.

Abstract

International studies of accounting have recognised the importance of ‘culture’ in accounting systems. Various definitions of and proxies for culture have been used in the accounting literature. These have contributed little to our understanding, save that culture is a complex issue and is clearly important for the development and practice of accounting.

This paper brings together two strands of literature (culture and regulatory compliance) to point out practical weaknesses in the transition to global reporting in the form of International Financial Reporting Standards (IFRS). The discussion centres on the European Union (EU), a culturally diverse region that is requiring the use of IFRS in the consolidated financial statements of listed companies from 2005. The article goes on to contribute to the emerging literature on enforcement by proposing a model for policing IFRS.

1. Introduction

An English accounting academic was exploring the sights of Helsinki one bright Sunday morning. As she crossed the road to reach the Kiasma Museum of Contemporary Art she became conscious of disapproving looks. What was her crime? Kiasma has been controversial, but should visitors be discouraged? Was her attire inappropriate for a Sunday? No, she had walked across the road when the traffic signals indicated that pedestrians were to wait. In spite of the fact that there was no traffic in sight, this offence carried a significant fine. This was in contrast to the academic’s native land where pedestrians are permitted to cross the road on a red signal (although they obviously do so at their own risk).

This anecdote highlights the differences in regulations that remain in Europe despite the fact that nearly half a century has elapsed since the Treaty of Rome and subsequent efforts to secure free movement of people, goods and capital. More importantly, it emphasises different attitudes to regulation: once the English woman had established the reason for the Finns’ disapproval, she continued to flout the regulations. As far as she was concerned, if there were no vehicles in the vicinity, she would cross the road; she was not prepared to follow the regulations and wait at the kerb, when such a delay to her progress seemed unnecessary. So while the *de jure* regulations were the same in the two countries – pedestrians should only cross on a green signal – the *de facto* regulations were different – pedestrians were free to override the regulations in England, but not in Finland.

The story provides the inspiration for this paper. It seeks to identify different attitudes to regulation and to predict how these will affect the next stage of harmonisation of financial reporting in the European Union – the transition to International Financial Reporting Standards (IFRSs) by all listed companies by 2005. There remains a concern that varying attitudes to regulations could undermine the success of one of the most significant stages in the history of harmonisation of financial reporting. The paper concludes by putting forward some suggestions for minimising the damage that could be caused by these differences.

Harmonisation of financial reporting has been an ongoing process in the European Union since the early days of exploration of similarities and differences that led to the adoption of the Fourth European Directive on Company Law in 1978. The process of formulating the Directives and implementing them in member states' national legislation has been explored in detail in the literature (e.g. Diggle and Nobes, 1994). This has highlighted the difficulties associated with introducing changes to bring regulations in line with those used elsewhere, perhaps formulated in an alternative paradigm. Walton (1996) argues that the result is simply an additional layer of regulation appended to the existing system, rather than replacing it. Consequently, the 'success' of the new regulations (measured in terms of compliance) will be dependent on attitudes to regulations in each country where they are implemented.

2. Identification of national culture

'Culture' is used here to describe the mind-set that is the result of historical, geographical and linguistic influences on a nation. Research into national culture from the perspective of management has been dominated by (although is not exclusive to) the field of occupational psychology. Hofstede's (1980) work on attitudes of IBM employees in different countries is regarded by many as the starting point of this line of enquiry, and most of the work on accounting and culture works from that premise. This classified national cultures on the basis of a number of key values. Subsequent cross-cultural studies have looked at areas such as leadership in different cultures and the challenges of managing in a different culture from the one in which one was brought up. The most relevant of these studies to the current investigation are those concentrating on Europe. Global studies have the disadvantage of classifying all (or most) European cultures in one group as they are more like each other than the other regions of the world. Hofstede (1980) was looking at forty countries and therefore could not look at all the countries in detail. Most Europeans would be keen to point out national differences within the region, simply because they have more comprehensive knowledge. Recent research (e.g. Garcea, 2001) has highlighted the continuing importance of perceptions of national identity, although the effect of internationalisation on accountants has been recognised as increasing communication and openness with the recognition of the importance of looking beyond national boundaries (Granlund and Lukka, 1998).

The difficulties of classifying European culture are demonstrated by the following examples. Ronen and Shenkar (1985) identified five European cultural clusters (Anglo, Nordic, Germanic, Latin and Near East). Trompenaars (1993), Jago *et al* (1993) and Smith, Dugan and Trompenaars (1996) highlighted the importance of the East/West split of European cultures. However, re-analysis of the Smith, Dugan and Trompenaars (1996) data by Smith (1997) generated evidence of a North/South divide. Brodbeck *et al* (2000) built on this work to provide further evidence of differences in leadership styles. They concluded that '[s]ince European cultures are diverse and are unlikely to merge in the near future, we believe that the ability to build conceptual bridges between cultures will remain a key competence for cross-cultural leadership, not only in Europe, but also worldwide' (p.26).

3. National culture and accounting

One reason for the difficulties in identifying national cultures in the studies described above is the influence of other factors, such as the culture of a particular firm or profession or even the fact that the companies examined were multi-national and, therefore open to other influences. In the accounting literature, evidence has been found (e.g. Soeters and Schreuder, 1988; Pratt *et al*, 1993; and Chow *et al*, 2002) that the organizational cultures of the major (essentially US) accounting firms influence those of their overseas affiliates. This then has the potential to influence domestic firms through professional associations.

Nevertheless, other work has demonstrated similarities between classifications of accounting systems and cultural groups. Hofstede pointed out in 1986 that the less an activity is technically defined, the more it is ruled by values and thus influenced by cultural differences. At that time, he felt that accounting was a field in which technical imperatives were weak, so accounting systems would be expected to vary along cultural lines. Gray (1988) put forward a hypothesis of classifying accounting systems based on accounting values derived from Hofstede's (1980) cultural values. Salter and Niswander (1995) attempted to test Gray's (1988) theory by taking previously published research (e.g. Douppnik and Salter, 1993; Bavishi, 1991) and applying statistical tests. This indicated that Gray's (1988) model had statistically significant explanatory power. However, criticisms of the underlying data used in the previous studies (e.g. Tay and Parker, 1990; Nobes, 1981) mean that these findings should be treated with some degree of caution. Sekely and Collins (1988) examined the relationship between culture and debt. They found that '[a]lthough [the cultural] groupings do not conclusively prove the cultural impact on financial structure, they do give clear indication of the influence in that direction' (p.99). The logical extension of these results is that, if capital structures are different, then users will have different needs, which could influence financial reporting.

The studies described above were conducted when the harmonisation of financial reporting was in its infancy. Accounting systems still largely reflected national history and traditions (see Nobes, 1992, for example, for characteristics of national accounting systems). The Directives contributed a great deal to the harmonisation of the presentation of annual reports, but still permitted variations in the underlying calculations due to the existence of member state options, local tax regulations and the existence of more detailed national accounting regulations (e.g. Walton, 1992). Mechanisms for setting national regulations vary from country to country (e.g. Bloom and Naciri, 1989). The requirement for all EU listed companies to comply with IFRSs in their consolidated financial statements by 2005 has the potential to reduce the number of national differences, as all listed companies will be following the same detailed accounting regulations. However, there is still the possibility for differences, if varying attitudes to compliance with regulations exist in member states.

4. Non-accounting regulations and attitudes to them

It is said that in Germany everything is forbidden unless it is allowed, in England everything is allowed unless it is forbidden and in Italy everything is permitted even if it is forbidden. While variations on this ‘joke’ play to national stereotypes, they are funny because people recognise different national characteristics. They are based on the premise that there *are* different national attitudes to regulations. This section of the paper considers national attitudes to regulations in general.

One way of separating ‘accounting’ and ‘national’ cultures might be to examine an area of regulation that applies to the majority of citizens and is widely known, so that it is not affected by sub-cultures associated with particular classes or professions. Ideally, the chosen area of regulation would have readily observed attitudes to compliance. Following on from the experience that inspired this paper, the regulations associated with road safety seem to meet these criteria.

In addition to different national attitudes to compliance with regulations by citizens, there are also different attitudes to enforcing regulations by regulators as well as differences in the regulations themselves. The Interpol website¹ points out ‘The data [relating to crime] is not intended to be used as a basis for comparisons between different countries since the statistics cannot take account of the differences which exist between definitions of punishable acts in different national laws.’ Consequently, an indicator had to be chosen that was not affected by variations in regulations or enforcement.

One aspect of road safety regulations that is the same across EU member states (due to a Directive) is the wearing of seat belts. It proved difficult to obtain comparable statistics for seat belt usage in the EU, but Figures 1 and 2 provide some indications. There are similarities between countries for usage among different groups of people in the cars and on different types of roads. Nevertheless, compliance in some countries is poorer than others. However, the groupings do not readily match with the cultural groups identified in other types of research (e.g. Hofstede, 1980). For example, Greece (second country on Figure 2) might be expected to have cultural similarities with Spain and Portugal (seventh and eighth countries on Figure 2), but the level of compliance with seat belt regulations is much greater in the latter two countries.

It could be argued that the variations in the seat belt usage rates could be associated with the different dates when seat belt regulations were implemented. However, work in the US (Cohen and Einav, 2001) in states where mandatory seat belt laws were passed, repealed and reinstated again in the late 1980s (Massachusetts, Nebraska, North Dakota and Oregon) showed that usage rates dropped rapidly with the repeal of the laws and increased

¹ www.interpol.int/Public/Statistics/ICS/Default.asp

immediately after the laws were reinstated. This would seem to suggest that the date of implementation is irrelevant.

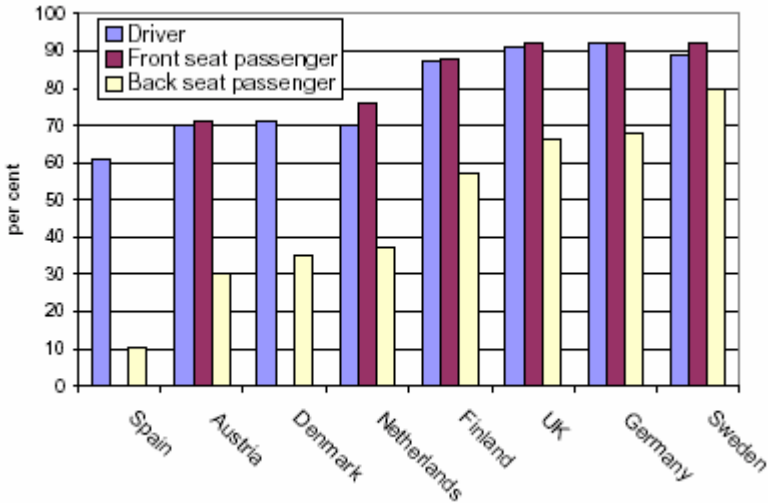


Figure 1: Seat belt usage for drivers, front or back seat passengers in some countries 1992-1995 (Source: ETSC, 1996)

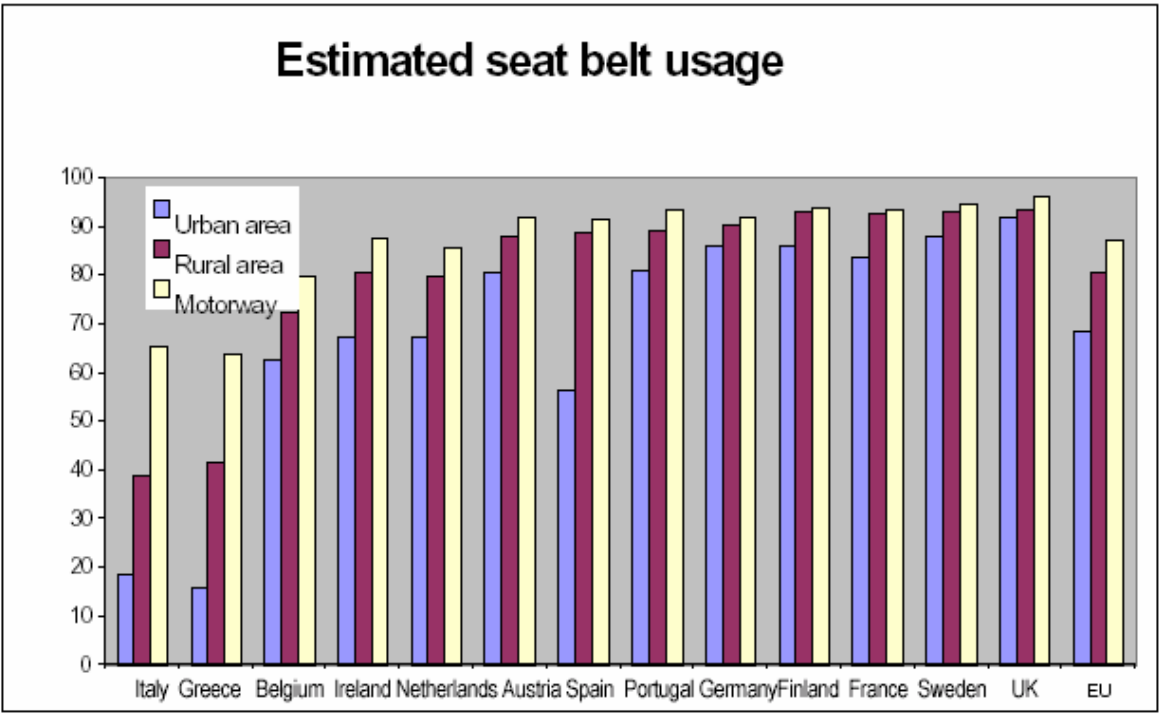


Figure 2: Estimated front seat belt usage among drivers in some European countries on motorways, other rural areas and urban areas (Source: SARTRE, 1998)

A major cause of accidents on the roads is driving when impaired by excessive alcohol. Table 1 makes somewhat depressing reading as it demonstrates that the countries with the highest permitted level of blood alcohol (BAC-limit) had among the highest percentage of drivers

over the legal limit, in spite of the threat of a roadside breath test (RBT). It may be that attitudes to alcohol take precedence over attitudes to compliance with regulations. Nevertheless, there are some similarities with the seat belt statistics: Finns seem to generally be more compliant with regulations, whereas the people of the Netherlands take a more liberal approach. Unfortunately these statistics are not available for all EU countries, but those that are available do not readily fall into any of the recognised cultural groups.

Table 1: Legislation, enforcement possibilities and enforcement parameters in different European countries (examples) (Source: ETSC, 1999)

Country	Legal BAC-limit promille	RBT	Evidential Breath testing	% of drivers over the legal limit	% of drivers who think they will not be breathalized on a typical journey (SARTRE)	Number of breathtests per licenced driver
Finland	0.5	Yes	Yes	0.2 (1990s)	11	4 drivers in 10
France	0.5	Yes	Yes	1.7 (1996; BAC-limit 0,5) 2.4 (1990., BAC-limit: 0,8)	26	1 driver in 4
Netherlands	0.5	Yes	Yes	4.3 (1997)	32	@ 1 driver in 16
Sweden	0.2	Yes	Yes	0.2 (1996)	19	1 driver in 5
United Kingdom.	0.8		Yes	1 (1990s)	49	1 driver in 30
Switzerland.	0.8	No	No	4.4. (weekend night, 1987)	41	Not known

If it is reasonable to use these statistics to gain a sense of attitudes to regulations (and it may not be), then it seems there are national differences in attitudes to regulations. However these are not universal – e.g. in the UK seat belt compliance was higher than alcohol compliance in relation to the other countries measured in comparable periods. It therefore seems inappropriate to assume specific national attitudes to compliance with regulations and hence make predictions about likely compliance with accounting regulations on that basis. However, as a sub-set of national populations (with more in common in terms of education, if not social background), it may be that accountants *do* exhibit national characteristics in their attitudes to regulations. Chacko (1991) demonstrated (in the US) that accounting students differed from other business students and tended to be more ‘conventional’ on the Strong-Campbell Interest Inventory. Conventional people are said to be self-controlled and conscientious (Holland, 1985). Consequently, accountants might be expected to be more likely to comply with regulations than the population in general.

5. Comparisons between attitudes to non-accounting regulations with accounting regulations

There have been accounting regulations in place throughout the EU for a number of years, so it should be possible to build up some picture of compliance. Unfortunately there are no readily comparable statistics between countries. There are figures about specific countries and some of them seem surprising when compared with certain national stereotypes. Haller (1998) points out that around 90% of German private limited companies (GmbHs) do not make the required disclosures in the commercial register (*Handelsregister*). He argues that this is because penalties for non-disclosure are light and the risk of imposition is low. This seems to be in contrast with the relatively high levels of compliance with traffic regulations described above. Filing requirements are generally satisfied in Great Britain: in 1996/7 95.1% of companies had complied with filing requirements and this rose to 95.4% in 2001/2 (DTI, 2002). While penalties for late filing can be relatively slight (fines are not related to the size of the company, for example), Companies House in Cardiff does prosecute offenders with enthusiasm.

Surveys of financial statements (e.g. Rundfelt's annual survey of trends in Swedish listed companies' annual reports; KPMG's analysis of 50 Danish listed companies) highlight deficiencies in the information disclosed by companies compared with the requirements of relevant regulations. Regulators in certain jurisdictions (e.g. the UK) publish the results of disciplinary enquiries into shortcomings of financial statements. This kind of data builds up a picture that there is an element of non-compliance in all countries, but it does not allow measurement of the extent of it or direct comparisons between countries.

A number of EU companies have chosen to publish financial statements in accordance with International Accounting Standards (IAS). As early adopters, they might have been expected to show some enthusiasm for complying with the standards. However surveys by Cairns (most recently in 1999) and research by Street, Gray and Bryant (1999), Street, Nichols and Gray (2000), Street and Bryant (2000) and Street and Gray (2001) have all demonstrated disappointing levels of compliance, although the effect of IAS 1 (revised) might lead to further improvements as it is understood more fully. Nevertheless, these studies highlight potential areas of difficulty, e.g. Street and Gray (2001) report that 'compliance tends to be more problematic for companies domiciled in some Western European countries, notably France and Germany' (p.53). It is not yet clear whether these examples of poor compliance can be attributed to ignorance (on the part of preparers and auditors) or lack of enforcement (primarily on the part of auditors).

The issue of the ‘true and fair override’² has been discussed extensively in relation to the implementation of the Fourth Directive and this is now being extended to IAS (e.g. Alexander, 1993; Nobes, 1993; Alexander, 1999; Nobes, 2000; Alexander, 2001; Aisbitt and Nobes, 2001). Certain nationalities (e.g. Germans) never seem to have been able to come to terms with the concept of overriding accounting regulations (e.g. Ordelheide, 1993 and 1996) although they can see the value of providing additional information in the notes to the accounts³. This does seem to be an area where national culture prevails, but it is ironic that the most vociferous nation is one where non-compliance can readily be observed in relation to other accounting regulations (as described above).

Empirical research on auditing (Chan, Lin and Mo, 2003) has demonstrated that audit-detected accounting errors in foreign controlled companies in China can be explained by cultural dimensions (determined by reference to the nationality of the owner). This may be useful for predicting where (possibly involuntary) non-compliance might be more likely.

6. Beyond the cultural model towards an enforcement model

In spite of the volume of literature supporting it, Jensen and Meckling (1994) argue that the idea that individuals are a product of their cultural environment is based on a sociological model of human behaviour, whereas an alternative view of the Resourceful, Evaluative, Maximizing Model (REMM) might be more appropriate. They illustrate this model by reference to the introduction of a 55mph speed limit instead of 70mph. Compliance with the regulation was poor, because drivers were able to calculate the value of the additional time spent driving. They sought out methods of avoiding detection of their violation of the regulation (e.g. through use of Citizen’s Band radios and radar detection equipment) rather than complying with the regulation. Jensen and Meckling (1994) go on to make the case that, assuming an REMM, penalties need to be designed to encourage compliance. Böckem (1998) was effectively using REMM in her investigation of the UK’s Financial Reporting Review Panel, which argued that ‘compliance with prevailing accounting standards is induced if the expected disadvantage due to sanctions imposed if non-compliance is detected outweighs the advantage of non-compliant accounting choices’ (p. 0).

Another advantage of the REMM is that it provides a foundation for changing what has hitherto been regarded as organizational (or national) culture and this can be achieved through education. Jensen and Meckling (1994) use the example of the success of Singapore’s anti-drug policy – arrivals to the country sign a statement recognising that possession or sale of

² The Fourth Directive on Company Law states that the financial statements should give a true and fair view (TFV) of the state of affairs of the company at the balance sheet date and of its result for the year then ended. Additionally, if following the details of the Directive would not give a TFV, then companies should depart from the provisions of the Directive – this is known as ‘the override’.

³ When Germany implemented the Fourth Directive into its national law it did not implement the clause of the Directive relating to the ‘override’ on the basis that according to German legal tradition a general provision can never take precedence over a specific provision. It is further argued that it should always be possible to provide sufficient information in the notes to the accounts to give a TFV without needing to invoke the override.

drugs is punishable by death. Punishment for infringement of Singaporean law is carried out swiftly and publicly. Recent scandals, such as Enron and Worldcom, have raised awareness among accountants and auditors of the importance of transparent financial reporting. Thus the educational process has already begun and there is a greater awareness for a need to comply with the spirit of accounting regulations' underlying principles. The demise of Andersens has demonstrated that the consequences of not doing so, in many countries, go beyond the penalties that might be imposed for violation of financial reporting regulations. Evidence has also been gathered (e.g. Glaum, 2000) of increased acceptance of non-national accounting regulation, particularly IAS.

As the process of education will take time, one solution might be for penalties based on national social conventions to encourage swift compliance. So, in the case of IFRS, the best route to high levels of international compliance from the outset may be through national penalties. While this may seem counter-intuitive in the light of the aims of IFRS, it is not without precedent. The EU-wide regulations on the wearing of seat belts discussed above are enforced by different mechanisms and with different penalties in each Member State.

Enforcement of accounting regulations is an area of research that has generally been neglected (Hope, 2003), but Hope (2003) was able to demonstrate a positive relationship between the enforcement environment and the quality of financial statements. Hope (2003) formulated a metric for enforcement by country based on factor analysis of (1) country-level audit spending, (2) judicial efficiency, (3) rule of law, (4) insider trading laws (existence and enforcement) and (5) shareholder protection (antidirector rights). Looking at the figures for European countries prepared by Hope (2003) shown in Table 2, the pattern of (non-) compliance discussed above seems to bear a close relationship to the enforcement metrics. The higher the metric, the higher the level of enforcement hypothesised by Hope (2003), so the UK is perceived as having the highest level of enforcement.

In an international financial reporting environment we need to go beyond existing national attitudes and regulatory structures. Accounting standard setters have traditionally concentrated on the needs of users and there has been a gradual trend towards regarding investors as the primary user group. In terms of the purposes of this paper, users' needs for information can be considered as varying according to (1) users' 'home' culture and (2) the level of risk involved. The highest level of risk will be encountered when investing furthest from 'home'. Distance can be measured in terms of culture, business or investment type as much as geographical remoteness. This might be represented graphically as shown in Figure 3.

Table 2 Descriptive statistics for enforcement (and its components) ranked according to enforcement metric (Source: Hope, 2003)

Country	Enforcement	Audit Spending	Insider Trading Laws	Judicial efficiency	Rule of Law	Anti-director rights
United Kingdom	1.16	0.6	2	10.00	8.57	5
Sweden	0.55	0.36	2	10.00	10.00	3
Netherlands	-0.19	0.68	1	10.00	10.00	2
Finland	-0.22	0.12	1.5	10.00	10.00	3
Denmark	-0.56	0.43	1	10.00	10.00	2
Ireland	-0.78	0.70	1	8.75	7.80	4
France	-0.99	0.20	2	8.00	8.98	3
Austria	-1.65	0.14	0.5	9.50	10.00	2
Belgium	-1.89	0.18	1	9.50	10.00	0
Germany	-2.92	0.15	0	9.00	9.23	1
Portugal	-3.21	0.18	1	5.50	8.68	3
Italy	-3.55	0.10	1	6.75	8.33	1
Spain	-3.65	0.16	0	6.25	7.80	4

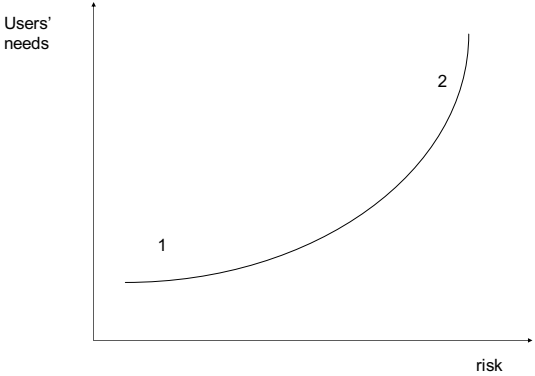


Figure 3: Variations in users’ expectations of financial statements according to their risk position

Investor 1 might be a person from a country with low expectations of the information content of financial statements contemplating an investment in a domestic company in a sector with which they are familiar. At the upper end of the curve, investor 2 might be someone with high expectations of financial statements (because of their ‘home’ culture) considering a more risky investment opportunity.

These different user needs affect both the formulation of accounting regulation and their enforcement. The public consultations on draft regulations (e.g. by the IASB) go some way towards meeting user expectations. In Europe, the endorsement mechanism should provide yet further quality assurance of the standards. The highest quality accounting standards will assume the highest expectations among users (subject to some kind of cost/benefit ceiling). The satisfaction of users' needs may be represented as shown in Figure 4.

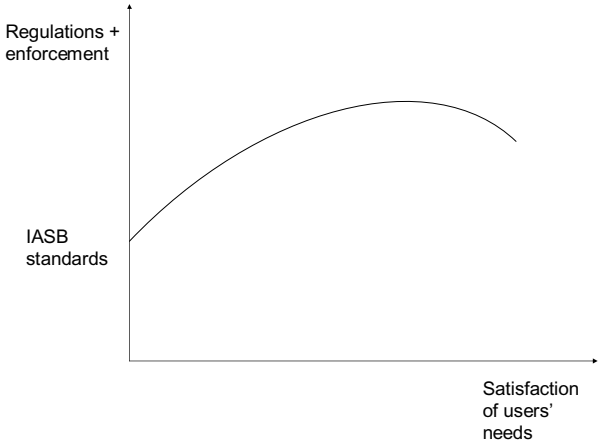


Figure 4: User satisfaction and the interplay between regulations and enforcement

In an environment where a single set of regulations applies (e.g. IFRSs), then the regulations will be constant, so the only variable is the way the standards are enforced. Users now expect some kind of regulation of financial statements, but they are only likely to be satisfied with the resultant financial information if the regulations have been enforced. Their satisfaction will start to diminish when the cost of enforcement (in terms of charges or delays in the publication of the information) exceeds levels determined by their personal circumstances and risk preferences.

The first stage is to ensure IFRSs themselves are clear and there is appropriate guidance for those applying them (particularly the first time). The IASB has given itself a punishing schedule to achieve this, with the 2005 deadline in mind. The second stage is to produce official translations of the standards for endorsement and use within the EU. Unsurprisingly, the preparation of the translations has fallen somewhat behind schedule. Given the difficulties in ensuring different language editions of the standards are comparable (see the discussions of different language versions of the Directives discussed in the literature on the True and Fair View referred to earlier), this is a potential minefield. Thirdly, there needs to be an effective enforcement mechanism.

At the same time, auditors need to prepare for the change as they will be the first line of defence in enforcing the standards. Large firms of auditors have started training staff in IFRS and there has been talk of staff not being allowed to audit IFRS financial statements until they

have passed some internal test. The International Auditing and Assurance Standards Board (IFAC) is gaining momentum in its efforts for establishing a framework for policing IFRSs, with documents such as the Exposure Draft for *Reporting on Compliance with International Financial Reporting Standards* (published in October 2002). This would provide a useful benchmark for auditors of IFRS financial statements. However, there is no guarantee that all EU auditors will be willing to forsake national audit standard setters to rely on this guidance. Nor is there any guarantee that such a move would be successful if it were made.

The market regulators also have a role to play: the Forum of European Securities Commissions (FESCO) published *FESCO's response to the EU's new accounting strategy* (February 2001). This is in addition to the work being done by the IASB and the European Commission. It is important that there should be some kind of enforcement on an international level to ensure IFRSs are being applied consistently and to overcome the problems associated with varying national attitudes to compliance. Perhaps this could involve some supra-national regulation of auditors.

Earlier in the paper it was suggested that German companies do not comply with filing requirements because the penalties are slight. The role of the Financial Reporting Review Panel (FRRP) in maintaining high standards of reporting in the UK has been widely praised, but Böckem (1998) found that the capital market related sanctioning by the FRRP may not unfold a sufficient threat potential, which is a prerequisite for compliance enhancement. There is certainly a need for more research into the kinds of penalties that are likely to be most successful in ensuring compliance with regulations. It may be that, while all EU companies should be following the same regulations, different penalties could be imposed in different countries to make the incentives for compliance more relevant. This could be the point at which understanding of national culture could be applied to ensure acceptable levels of compliance.

In the meantime, this paper puts forward some more radical suggestions for improving the training and development of auditors along with drawing on best practice for enforcement to provide a model of enforcement of IFRS. The model is based around a 'virtuous circle' of auditors, national stock exchanges and a supranational regulator (Figure 5). This would allow for clear lines of communication between interested parties and would ensure national strengths are shared to the benefit of all stakeholders. The supranational regulator would ensure a co-ordination of the effort of the other parties.

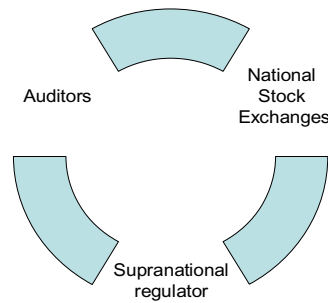


Figure 5: The ‘virtuous circle’ of enforcement of IFRS

The Fédération des Experts Comptables Européens (FEE) put forward a discussion paper (2003), *European Enforcement Coordination*, based on the Committee of European Securities Regulators (CESR) Standards on Financial Information Numbers 1 (Enforcement of Standards on Financial Information in Europe) and 2 (Coordination of Enforcement Activities⁴). The discussion paper sets out in detail the importance of setting up structures for co-operation between existing regulators and makes important points about confidentiality, interpretations and the setting of precedents. However, FEE (2003) stopped short of a single supranational regulator, but CESR’s Standard No. 2 seems to be setting CESR up as the *de facto* super regulator. Neither FEE nor CESR discuss the role of auditors. They seem to take the view that they can simply be covered by National Enforcers or National Stakeholders, which is a pity when, even now, many auditors take an international perspective.

In the final quarter of the twentieth century European rail companies collaborated to allow young people to travel throughout their networks for a fixed fee for a period (usually four weeks) through the ‘Inter-Rail’ scheme. The Inter-Rail ticket was very reasonably priced and enabled a large number of youngsters to broaden their horizons by travelling throughout the region and meeting people from other cultures. Many people in their 40s are happy to agree that Inter-Rail did more for promoting the benefits of a European Union than any of the efforts of politicians. This model for enforcing IFRS draws much from the Inter-Rail ideal.

As discussed above, the training and continuing professional education of accountants and auditors in IFRS is vital. However, the development of accountants needs to be extended to include cultural elements, in much the same way as it is becoming increasingly accepted that their training should incorporate ethics. While efforts could be made to provide this kind of education in a ‘classroom’ setting, a more effective approach might be to include a period of work placement (‘internship’) with a firm of auditors in another country. To make the most of this opportunity, auditors should arrange to visit a country that is as far removed as possible from their own in terms of its culture. This would allow auditors to see others at work in a different culture and to identify the effect that this has on their work as an auditor. At its best it would encourage auditors from a lower compliance country to recognise the

⁴ This was in draft at the time of FEE (2003) but has now been published in final form.

benefits of complying with accounting regulations. The other two elements of the ‘virtuous circle’ model would ensure that auditors do not simply adopt the ‘lowest common denominator’.

National stock exchanges already have an important role to play in regulating the financial markets. In a number of countries this extends to accounting requirements. This seems a logical approach as the markets should benefit from high quality financial information. Changing the regulatory system cannot be done overnight, but some simple steps could improve the situation with relatively little effort and cost. In the same way that companies’ audit committees benefit from the input of non-executive directors, the regulatory units of National Stock Exchanges could make good use of ‘foreign’ experts. Once again, representatives from countries with a high ‘compliance culture’ could encourage those with lower levels of compliance to improve their standards.

Finally, there needs to be some ultimate authority to prevent any individual stock exchange taking its own route. The supranational regulator could be at a regional level in the first instance (e.g. for the EU). It could include representatives from all member countries. However, it should also include representatives from (or possibly be chaired by an individual from) outside of the region. The ‘outsider(s)’ should ideally come from countries with a high level of enforcement but an understanding of the region’s cultural diversity. Consequently outsiders for a European super regulator might be drawn from Australia or the United States of America. The structure of the supranational regulator might be based on successful efforts on a national level, e.g. the UK’s FRRP. While this appears to be adding an additional layer of bureaucracy, in practice, it may not work this way. In the UK there is anecdotal evidence that auditors have been able to use the existence of the FRRP (and its powers to make companies restate their accounts) to persuade directors to comply with regulations. It is a credit to the FRRP that it has never (yet!) had to take a company to court to achieve compliance.

The model takes the form of a circle deliberately. However, this is not intended to mimic the traffic device of a ‘roundabout’ (or ‘rotary’), which can force drivers to go round in circles and never reach their destination! To be successful there needs to be communication in both directions between the three different groups to allow them to constantly refine their processes and to meet the challenges of new accounting issues.

7. Conclusion

The success of the International Accounting Standards Board (IASB) in providing a framework for high quality transparent comparable financial statements depends not only on the quality of its standards, interpretation and framework, but also on compliance with those regulations by preparers of financial statements. This paper has explored national attitudes to regulations both within and beyond accounting. It has established that there are different attitudes to complying with regulations in different countries, but these seem to vary from one

requirement to the next. This applies to both accounting and non-accounting regulations. Consequently, it is difficult to predict which countries or regulations are likely to be problematic.

Research into road safety (e.g. ETSC, 1999) has demonstrated that regulations to promote road safety are only successful if they are enforced effectively. Some methods of enforcement (e.g. speed cameras) have proved very effective in certain countries with a 'halo effect' up to several kilometres away from the camera, as drivers recognise the importance of keeping their speed below the limit (ETSC, 1999). However, speed cameras would not be socially acceptable in some countries, as they are considered to be an infringement of civil liberties.

Enforcement of IFRS must therefore be taken seriously, but needs to be tackled within the context of national culture or national conventions. There is a danger that national and international organisations are all being very busy as they prepare themselves for 2005, but miss the opportunity to set up a simple and effective enforcement mechanism. The model put forward in this paper might form the basis for such a mechanism.

8. References

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