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A REVIEW OF RESEARCH ON THE RELATIONSHIP BETWEEN INTERNATIONAL CAPITAL MARKETS AND FINANCIAL REPORTING BY MULTINATIONAL FIRMS

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1.0 INTRODUCTION

In this paper we extend an earlier survey (Meek and Saudagaran [1990]) on research in transnational financial reporting.[1] An impressive amount of research has been published in the area since that paper appeared. [2] The trend toward global capital, including international share listings, has accelerated in the 1990s.[3] As a result, issues surrounding transnational financial reporting figure more prominently on the agendas of accounting policy making bodies around the world, and they concern an increasing number of investors and companies.

Our purpose is to review and synthesize this recent research literature.[4] Since the earlier survey, the literature has taken several new directions. As such, our goal is to

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[1] The term "transnational financial reporting" refers to financial reporting across national boundaries or, more specifically, to reporting financial results to user groups located in countries other than the one where the company is headquartered. Section 4.1 of Meek and Saudagaran [1990, pp. 160-162] discusses the various approaches that companies take to accommodate foreign readers of their financial reports.

[2] Prather and Rueschhoff [1996] document that, insofar as U.S. academic journals are concerned, financial reporting is the most prevalent topic in international accounting, occupying almost 45 percent of the total since 1980. They also note that the number of financial reporting articles in the 1990s increased over earlier periods. Zeff [1996] notes that five new accounting journals with a specific international focus have been launched or announced since 1987, in response the the growth in international and comparative research.

[3] Truly "global" capital is the seamless flow of capital around the world, unincumbered by restrictions or other market frictions. In reality, capital markets are national, but increasingly linked via information technology, as barriers to seamless capital flows fall. The term "international capital markets" refers to this latter phenomenon.

[4] We limit our survey to research published in English, but we canvassed U.S. and non-U.S. journals that were available through July 1997.

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identify the major themes and to discuss selected papers that, in our view, have advanced or best exemplify those themes. Besides describing and evaluating what we have learned from the research, we also suggest further research that may be essential. We provide a framework which we hope is useful to researchers in tying this literature together.

Our paper shares some of the subject matter discussed in other recent review articles, notably Prather and Rueschhoff [1996], Wallace and Gernon [1991], and Gernon and Wallace [1995]. However, the thrust and overall framework of our paper is different from these. Prather and Rueschhoff [1996] provide descriptive information on the trends since 1980 in topics and research methods used in the entire spectrum of international accounting research, but they do not attempt to synthesize it, nor do they comment on individual pieces of research. Wallace and Gernon [1991] are concerned with how to compare international accounting research; their emphasis is on the methodology of comparative international accounting research. Gernon and Wallace [1995] elucidate the underlying theories that support current international accounting research and they evaluate contending methodologies that have or can be used. While there is some overlap in the literature we both include, their motivation for discussing it differs from ours, and so our respective comments reflect different points of view.

This paper is organized as follows: Section 2 deals with diversity versus harmonization. Diversity prevails internationally in both generally accepted accounting principles (GAAP) and actual financial reporting practices, notwithstanding significant attempts to harmonize them. We look at the recent literature on the causes, effects, and measures of diversity, along with the extent to which harmonization has been achieved. Section 3 is about disclosures by internationally-listed companies. These are the companies most affected by the issues surrounding diversity and harmonization. Section 4 is concerned with multiple GAAP reporting, an increasing trend in transnational financial reporting. Section 5 provides concluding observations. Generally speaking, we do not repeat papers discussed in Meek and Saudagaran [1990] unless they bear on recent work.

The foregoing embrace the principal streams of recent research on transnational financial reporting. However, there are several areas that we omit. First is the literature on accounting in emerging economies. The shift towards open market economies in countries that until recently had communist or socialist centrally-planned economic systems is having a dramatic effect on their financial reporting. To attract capital from abroad, these countries are being forced to revamp their financial reporting so that foreign investors have meaningful and relevant information. This phenomenon is currently in a state of flux with different countries at different stages of drafting and adopting new standards and practices. Much of the accounting literature is descriptive and reflects the authors' opinions as to what is likely to happen in these countries. In our opinion, it will take a few more years before a clear picture emerges of their financial reporting models. Second is an emerging literature on disclosures of a social nature, particularly as they relate to corporate environmental performance (e.g., Fekrat, Inclan, and Petroni [1996] and Gamble, Hsu, Jackson, and Tollerson [1996]). We omit this literature because, in our view, the influence of international capital markets on these disclosures is not apparent: whether international capital markets are developing a social conscience and an environmental awareness is not yet clear. Finally, we have not updated the survey on geographic segment reporting (Meek and Saudagaran [1990],

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Section 4.2) because this literature was recently reviewed by Herrmann and Thomas [1997].

2.0 DIVERSITY VERSUS HARMONIZATION

2.1 Causes of Diversity

A nation's accounting standards and practices are the result of a complex interaction of cultural, historical, economic, and institutional factors. It is unlikely that the mix is alike in any two countries, and diversity is to be expected. The factors that influence accounting development at the national level also help explain accounting diversity across nations. Meek and Saudagaran [1990] note that there is general agreement that the following five factors influence accounting development: (1) legal system, (2) nature of the relationship between business enterprises and providers of capital, (3) tax laws, (4) inflation levels, and (5) political and economic ties.[5] Other factors that have also been mentioned in the literature are (6) level of economic development and (7) education levels.

Cultural variables underlie nations' institutional arrangements (such as systems of law), and Meek and Saudagaran [1990] discuss a framework proposed by Gray [1988] for analyzing the relationship between culture and accounting. Gray's framework is developed from the pioneering work of Hofstede [1980] who enunciated four national cultural dimensions: (1) power distance, (2) uncertainty avoidance, (3) individualism, and (4) masculinity. The influence of culture on accounting is an area that has received attention since Meek and Saudagaran [1990]. The Hofstede/Gray framework is the basis for most of this work. Figure 1 summarizes Gray's proposed relationships between four "accounting values" and Hofstede's four cultural dimensions.[6]

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[5] Related to this last factor is history and historical accidents. For example, Walton [1995, p. 6] notes that many continental European countries adopted the Napoleonic Commercial Code in the nineteenth century and only introduced income tax later. Thus, they had established accounting rules before they had an income tax, which gave the tax authorities something to rely on. By contrast, income tax came at the end of the eighteenth century in the U.K., well before there were any established accounting rules. This seems to have left British accounting disconnected from taxation. Therefore, why tax laws and legal systems are important in Europe is their timing in history.

[6] The societal values (cultural dimensions) enunciated by Hofstede [1980] are: (1) *power distance* - the extent to which hierarchy and an unequal distribution of power in institutions and organizations are accepted, (2) *uncertainty avoidance* - the degree to which society feels uncomfortable with ambiguity and an uncertain future, (3) *individualism (versus collectivism)* - "I" versus "we," a preference for a loosely knit social fabric or and independent, tightly knit fabric, and (4) *masculinity (versus femininity)* - the extent to which gender roles are differentiated and performance and visible achievement (traditional masculine values) are emphasized over relationships and caring (traditional feminine values).

The accounting values proposed by Gray [1988] are: (1) *professionalism (versus statutory control)* - a preference for the exercise of individual professional judgement and maintaining professional self-regulation as opposed to compliance with prescriptive legal requirements and statutory control, (2) *uniformity (versus flexiblity)* - a preference for uniformity and consistency over flexibility in accordance with perceived circumstances, (3) *conservatism (versus optimism)* - a preference for a cautious approach to measurement so as to cope with the uncertainty of future events as opposed to a more optimistic, laissez-faire, risk taking approach, and (4) *secrecy (versus transparency)* - a preference for confidentiality and the restriction of information about business only to those who are closely involved with its management and financing, in contrast to a more transparent, open and publicly accountable approach.

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Salter and Niswander [1995] test Gray [1988] and find only mild support overall. Their results indicate that uncertainty avoidance is most strongly associated with Gray's accounting values. Individualism, which Gray thought would be relatively important overall, is only related to secrecy.[7] Power distance has no relationship to Gray's four accounting values, and masculinity is more strongly associated than Gray hypothesized. Fechner and Kilgore [1994] report Hofstede's admission that uncertainty avoidance significantly correlates with his other three cultural dimensions and it is the only one that does so. Thus, one explanation for the finding that uncertainty avoidance dominates the other three cultural dimensions is that it is a "summary index" for the other three cultural dimensions.

Gray's [1988] hypotheses have been refined by several authors. For example, he only proposes directional ("sign") relationships between cultural and accounting

Figure 1

RELATIONSHIPS BETWEEN GRAY'S ACCOUNTING VALUES AND HOFSTEDE'S CULTURAL DIMENSIONS

Cultural Dimension (Hofstede)	Accounting values (Gray)			
	Professionalism	Uniformity	Conservatism	Secrecy
Individualism	+	–	–	–
Power Distance	–	+	?	+
Uncertainty Avoidance	–	+	+	+
Masculinity	?	?	–	–

Note: "+" indicates a direct relationship between the variables; "–" indicates an inverse relationship. Question marks indicate that the nature of the relationship is indeterminate. Gray hypothesizes that individualism and uncertainty avoidance will influence accounting the most, followed by power distance, then masculinity.

Adapted from: Baydoun and Willett [1995, p. 71].

It should be noted that later work by Hofstede (Hofstede and Bond [1988] and Hofstede [1991]) documents a fifth cultural dimension, called "Confucian dynamism" (or, "long-term orientation"). This later work contends that only three of the original four cultural dimensions are universal: power distance, individualism, and masculinity. Uncertain avoidance is a unique characteristic of Western societies, whereas Confucian dynamism applies to Eastern societies but not to Western ones. However, Yeh and Lawrence [1995] note a data problem in this work. According to them, once the outlier is removed, Confucian dynamism no longer emerges as an independent construct; it reflects the same cultural dimension as individualism.

[7] Gray and Vint [1995], focusing exclusively on the secrecy dimension, find that it is significantly related to uncertainty avoidance and individualism. These results are consistent with Salter and Niswander [1995].

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dimensions. This has been extended to the relative influence of cultural dimensions on various accounting dimensions ("sign" and "size"). Thus, Baydoun and Willett [1995] argue that culture has a more important bearing on disclosure (i.e., the secrecy dimension) than on measurement (the conservatism dimension). Along the same lines, Fechner and Kilgore [1994] argue that cultural factors directly influence disclosure, while economic factors influence measurement. These proposals have yet to be tested empirically.

Integrating prior research, Doupnik and Salter [1995] model accounting development as a function of three interacting elements: the external environment, cultural values, and institutional structures. They also conduct a test of the ability of their model to explain measurement and disclosure practices in 50 countries using proxies for the seven factors enumerated above and from Hofstede's cultural variables. In addition, they provide some insights into the relative importance of environmental and cultural factors in explaining accounting development. Their results indicate that the type of legal system (code versus common law) is the dominant explanatory variable, and the basic point of departure in classifying accounting practices internationally. This is consistent with another study by the same authors (Salter and Doupnik [1992]) as well as earlier works, such as Nobes [1983]. The significance of equity as a source of finance and the cultural dimension of uncertainty avoidance are two other dominant factors. Next in importance are inflation, level of economic development, and masculinity, which are followed by level of education and power distance. Despite using recent data on accounting practices, the findings with respect to economic and institutional variables indicate that the same causes of diversity identified in earlier research[8] continue to explain diversity today. One must also be careful in interpreting the results of this study. For one, environmental and cultural factors are clearly correlated. For example, in looking at the three dominant ones identified by the study (legal system, source of finance, and uncertainty avoidance), code law countries tend to be uncertainty avoidant and rely less on stock markets as a source of finance, whereas common law countries tend to be less uncertainty avoidant and they have strong stock markets. Also, it is not clear whether cultural variables ought to "compete" head-to-head with, especially, institutional variables as explanations of accounting diversity. Since cultural variables underlie institutional arrangements, their impact on accounting is second-order. Third, the authors combine measurement and disclosure practices in constructing their dependent variable. While they present evidence that measurement and disclosure are correlated in their database (less conservative measurement practices associate with higher disclosure and vice versa), it is not clear why the two should be influenced in the same way by the same factors.

Overall, it is not clear to us that recent research on the causes of diversity has yielded much that is new and/or definitive. "Culture" remains a rather imprecise generic concept, one that is difficult to operationalize. Gernon and Wallace [1995, p. 91] worry that culture has often become "a residue for everything that cannot be explained by other factors" and question whether culture is really a homogeneous phenomenon within countries. While Hofstede may be the "best" framework that we have, it is incomplete. For example, religion—which extends beyond national boundaries—

[8] Nor apparently have classifications changed very much. The authors also cluster countries according to accounting practices and get basically the same groupings as earlier research. See Sections 2.3 and 3.0 in Meek and Saudagaran [1990].

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underlies business practices, institutional arrangements, and therefore accounting practices.[9] Language is another cultural input. Perera [1994] paraphrases comments made by Gerhard G. Mueller that accounting seems to flourish in English-speaking countries and to languish in most others, particularly Romance language countries.[10] Most of the related accounting literature has taken Hofstede [1980] as a given and accepted it uncritically, but Perera [1994] and Gernon and Wallace [1995] point out some reasons to have reservations. For example, Hofstede developed his framework based on data from one large MNC (IBM), and so may not be generalizable. Also, his data are old and there may have been some cultural shifts since the time of collection. Thus, there is substantial scope for refining the measures and other operationalizations of culture as a concept. Moreover, other cultural frameworks besides Hofstede's may yield different insights.

An area that has received relatively little attention is the comparative analysis of accounting standard setting. How accounting standards are set and the influences on the process in different countries help explain why standards vary around the world. Different standards are another cause of diverse practices. (However, the relationship between practice and standards is not one-way: in some cases practice derives from standards, but in others, standards confirm or legitimize practice.) Examples of this literature are Gorelik [1994], who looks at standard setting in Canada, the U. K., and the U. S., and McKinnon [1993], who compares Australia and Japan.

The extent to which the causes of diversity at the national level extend to the transnational level is an open question. Section 3.0 presents evidence on disclosures by companies competing for capital in international capital markets. Such companies are increasingly tailoring their financial reporting for a worldwide audience, notwithstanding the need to prepare financial statements in the first instance according to the rules of the country of their domicile. For this group of companies, international capital market pressures seem to be a counterforce to the causes of diversity at the national level. We conjecture that international capital market pressures are likely to be a primary cause for moderating accounting diversity in the future.

2.2 Effects of Diversity

A number of studies have looked at the diversity in financial reporting practices and their effect on firms. Issues examined include the effects of differences in disclosure levels on listing decisions (Biddle and Saudagaran [1991], Saudagaran and Biddle [1992, 1995], Cheung and Lee [1995]), effects of regulatory differences on user groups (Choi and Levich [1991] and Bhushan and Lessard [1992]), and the effects of differences in goodwill treatments on mergers and acquisitions (Choi and Lee [1991], Lee and Choi [1992], Dunne and Rollins [1992], Dunne and Ndubizu [1995]).

One stream of research in this area has examined how accounting and regulatory factors that result in differing levels of financial disclosure affect where companies list their stocks. For some time now there has been a fairly heated debate as to the level of disclosure that should be required by regulators and stock exchanges from foreign

[9] Hamid, Craig, and Clarke [1993] examine these relationships in the case of Islam.

[10] Of course, it may be that language is not a causal factor *per se*, rather correlated with other factors.

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firms listing within their jurisdictions.[11] From the regulators' perspective, the goal of protecting domestic investors from potentially misleading financial disclosures by foreign firms must be weighed against demands for increased access to investment opportunities (in foreign firms). The competitiveness of domestic stock exchanges and securities industries often hangs in the balance. In the United States, the Securities and Exchange Commission (SEC) and the New York Stock Exchange (NYSE) have been on opposite sides of the issue. The SEC insists that foreign firms' financial statements must be reconciled to U.S. GAAP for the protection of U.S. investors. The NYSE and others have argued that the reconciliation requirement imposes an unnecessary burden on foreign issuers which is keeping them from listing their securities on the NYSE and other U.S. stock exchanges. They complain that this has a number of adverse effects for the U.S. economy. It deprives U.S. investors of the opportunity to invest in many global "blue chip" companies. It reduces the competitiveness of domestic stock exchanges and securities industries relative to countries where the net regulatory burden is less than in the United States (Freund [1993], Cochrane [1994]).

Biddle and Saudagaran [1991] address three main issues related to the interaction between accounting diversity and the increasing globalization of the world's capital markets. They discuss 1) the benefits and costs of listing on a foreign stock exchange, 2) the effects of accounting disclosure levels on foreign listing decisions, and 3) accounting policy issues posed by foreign stock exchange listings and how authorities have responded.

From the accounting and financial reporting perspective, a key question in the debate outlined above is whether firms' choices regarding alternative foreign stock exchange listings are influenced by financial disclosure levels. Saudagaran and Biddle [1992] examine the listings of 302 internationally traded firms with at least one foreign listing, on one of the nine major exchanges, as of year-end 1987. Given the SEC's introduction of streamlined reporting requirements for foreign issuers via the Integrated Disclosure System (IDS) in 1982 and similar measures by Japan's Ministry of Finance in 1984, they also examine the changes in listings between 1981 to 1987. Financial disclosure levels for the eight countries in the study were obtained from a survey of 142 experts actively involved in the foreign listing process. Their results are consistent with the hypothesis that exchange choices are influenced by financial disclosure levels. Tests based on changes in listings between 1981 and 1987 provide evidence that financial disclosure levels remained a significant factor even after the relaxations in disclosure requirements by the SEC and the Ministry of Finance in Japan during 1982 and 1984, respectively.

Saudagaran and Biddle [1995] revisit the question of whether disclosure levels affect listing choices by looking at a significantly expanded sample of firms—450 firms from eight countries—that are listed on at least one of the major stock exchanges at year-end 1992. This allows them to study a ten year period (1982-1992) versus a five year period (1982-1987) since the 1982 implementation of the IDS rules in the U.S. to determine whether IDS has indeed facilitated foreign firms listing in the U.S. The results of this study are consistent with the findings in their earlier work that financial disclosure levels were still a significant factor in the choice of foreign stock

[11] See, for example, Torres [1990, 1991], LaBaton [1991], Freund [1993], Breeden [1994], and Cochrane [1994].

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exchanges. Overall, the evidence lends credence to the concerns expressed about the effects of stringent disclosure levels on capital market participants. Accounting academics have traditionally refrained from making policy recommendations based on their research. However, developments in the capital markets combined with the mounting evidence on the costs and benefits of certain reporting requirements suggest that academics might need to be more forceful in the conclusions they draw and the conviction with which they discuss the implications of their findings. The following quote from Edwards [1993, p. 36] succinctly sums up the criticism of the SEC's stance on reporting requirements for foreign private issuers:

> First, to the extent that foreign countries currently impose less burdensome reporting standards on firms, U.S. firms now operate at a competitive disadvantage. U.S. investors are already trading the securities of unregistered foreign firms in volume in foreign markets. Second, the SEC's argument implicitly assumes that its present disclosure requirements are now optimal; that is, it implicitly assumes that investors are unwilling to pay for the additional information U.S. firms are required to disclose. Stated another way, if a foreign firm reports less information and investors recognize this as a deficiency, the firm's cost of capital will be higher than for a similar American firm. Alternatively, if by providing the information required by the SEC, an American firm's cost of capital is lower, there will be no incentive for U.S. firms to abandon the current disclosure policy. Third, to the extent that neither the U.S. firms nor U.S. investors value the additional information required by the SEC, but seek to relax disclosure standards to make them more compatible with those of foreign countries, current SEC requirements can be said to be sub-optimal—or too burdensome.

Cheung and Lee [1995] treat the level of disclosure required on exchanges as a signaling mechanism in a study that attempts to theoretically model the foreign listing behavior of companies. They consider a listing by a company on an exchange with stricter disclosure requirements as a credible signal of the company's future prospects. This means that such listings will result in better pricing for the shares of the firm. The benefits of this signaling come with the higher costs that are associated with listings on stock exchanges with more comprehensive disclosure requirements. Thus, according to Cheung and Lee [1995] for each firm the choice of a foreign stock exchange involves weighing the benefits of better pricing with the greater listing costs. The model in this paper is limited to one of many other potential benefits from listing (Saudagaran [1988]) that are likely to affect the choice of specific foreign stock exchanges by firms.

In related research, Choi and Levich [1991] and Bhushan and Lessard [1992] discuss the behavioral effects of accounting diversity on major categories of capital market participants. Both studies use surveys to gather their data. Choi and Levich [1991] ask 52 institutions consisting of investors, issuers, underwriters, regulators, standards boards, and credit rating agencies, located in Frankfurt, Zurich, London, New York, and Tokyo, 1) whether they perceive accounting diversity to be a problem, 2) whether and how these institutions attempt to cope with the diversity, and 3) whether problems associated with accounting diversity lead to capital market effects. They find that accounting differences are important and affect the capital market decisions (i.e., the geographic spread of investments, the types of securities selected, assessment of security returns or valuation, and information processing costs) of a significant number of

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the surveyed capital market participants regardless of nationality, size, experience, scope of international activity and organizational structure.

Bhushan and Lessard [1992] survey international investment managers from the U.S. and U.K. to determine whether and how they are affected by accounting diversity and by the presence or absence of quantitative reconciliation. The SEC has steadfastly held the opinion that reconciliation to U.S. GAAP is critical for investor protection. However, Bhushan and Lessard [1992] find that professional investors, while they regard reconciliation (along with all forms of additional information) to be useful, do not regard it as essential. The reason for this includes the fact that primary financial statements and local valuation are still most important. This paper has important policy implications because it both attempts to distinguish between the financial information that investors need as opposed to what they would like (particularly if they do not bear the costs of producing it), and it focuses on the cost of reconciliation. Since reconciliation is not costless it requires a serious cost-benefit analysis. Bhushan and Lessard [1992] conclude that the SEC's emphasis on reconciliation is not well-founded.

Another stream of research studies the effects of differing rules of goodwill on merger activity. Choi and Lee [1991] and Lee and Choi [1992] examine whether national differences in the accounting treatment of purchased goodwill are associated with differences in merger premia offered by non-U.S. acquirers when bidding for U.S. target companies. Choi and Lee [1991] focuses on acquirers from the U.K. while Lee and Choi [1992] looks at acquirers from Germany and Japan. They assess 1) whether U.K., German and Japanese acquirers consistently pay higher premia for U.S. targets than U.S. acquirers, 2) whether these premia are associated with accounting measures of goodwill, and 3) whether observed premium differentials are attributable to differences in goodwill accounting treatments. They find merger premia offered by foreign acquirers based in countries with more favorable accounting and tax treatments for goodwill than the U.S. to be higher than those offered by U.S. acquirers. Their analysis shows that goodwill accounting treatment does explain merger premia, and that the premia paid by British firms are substantially more than that paid by German and Japanese firms.

In a case study that uses identical acquisition scenarios for acquirer firms from the U.S., U.K., and Japan, Dunne and Rollins [1992] discuss the effects of differences in accounting for goodwill for financial reporting and tax purposes. Based on hypothetical scenarios they conclude that since Japan alone, of the three countries studied, allows the amortization of goodwill to be deducted for tax purposes Japanese firms have a cash flow, and thereby a competitive, advantage over firms from the U.S. and U.K. They also demonstrate that the U.K. acquirer experiences the highest reported income and rates of return because it is able to write off goodwill immediately against stockholders equity. The U.S. acquirer enjoys neither enjoys neither a cash flow nor a reported earnings advantage relative to firms from Japan and the U.K.

Dunne and Ndubizu [1995] study the effect of diversity in accounting and tax treatments for goodwill on target shareholders' wealth. *Ceteris paribus*, the odds of a successful acquisition increase as more wealth is transferred to target shareholders. They find that non-U.S. companies that write off goodwill against a reserve account transfer more wealth to the target shareholders than those that amortize goodwill against income. Foreign acquirers that deduct goodwill for tax purposes transfer more

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wealth to the target stockholders at the acquisition announcement than other acquirers. They conclude that this puts U.S. bidders at a disadvantage in their competition with foreign bidders to acquire U.S. firms.

Nobes and Norton [1996] and Nobes [1996] question the evidence and conclusions reached by the studies discussed above on the effects of differing rules of goodwill on merger activity on the grounds that these studies fail to distinguish between consolidation goodwill and non-consolidation goodwill (i.e., other purchased goodwill). While this may not be a problem for financial reporting in English-speaking countries because the accounting rules are generally similar for the two types of goodwill, they assert that the lack of distinction can cause problems when dealing with other countries or with tax reporting. Nobes and Norton [1996] argue that since the context of the goodwill studies is consolidated financial statements and the purchase of shares these studies are in error when they refer to the tax deductibility of goodwill because deductibility relates to goodwill arising on the acquisition of the assets of a business rather than the shares in it. In their response to Nobes [1996], Dunne and Ndubizu [1996] point out that Dunne and Ndubizu [1995] attempt to examine the differences in accounting and tax treatments for goodwill across countries and their possible effects on returns to U.S. target companies and that differences in goodwill were simply not a focus of their paper.

Overall, these findings indicate that diversity in accounting and/or tax treatments affects international merger activity. This conclusion makes sense to the extent that tax treatments are involved, since taxes have direct cash flow consequences. However, in environments where there is a dichotomy between financial reporting and tax reporting, such as in the U.K., it is puzzling why financial reporting diversity alone should have any effect on the terms of international mergers. Perhaps accounting treatments correlate with other variables such as market share and cost of capital that are the real causes.

The evidence presented in this section indicates that the effects of international accounting diversity are real. Various capital market participants and the terms of international transactions seem to be affected by it. As such, diversity imposes costs on the resource allocation system worldwide. Harmonization of this diversity may provide one solution and is discussed next.

2.3 Harmonization

With the dramatic growth in global trade and the accelerated internationalization of capital markets, financial statements produced in one country are used in other countries more and more frequently. This has brought accounting harmonization to the forefront as an international business issue. While accounting academics and others have offered several definitions of harmonization, some of which will be discussed below, very simply stated it is the process by which differences in financial reporting practices among countries are reduced with a view to making financial statements more comparable and decision-useful across countries. In this section, we address the following three questions in the area of accounting harmonization: 1) Is there a need for harmonization? 2) What factors help and hinder harmonization? and 3) What are appropriate measures of harmonization? We also discuss the evidence in extant research on the level of harmonization that has been achieved to date.

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2.3.1 Need for Harmonization

As noted in Meek and Saudagaran [1990], the debate over the need for and desirability of accounting harmonization began in the academic accounting literature in the 1960s and has continued unabated since.[12] The primary economic rationale in favor of harmonization is that major differences in accounting practices act as a barrier to capital flowing to the most efficient uses. Investors are more likely to direct their capital to the most efficient and productive companies globally if they are able to understand their accounting numbers (and so, presumably, their economic reality). However, if the accounting practices between countries are different to the point of imposing unreasonable burdens on capital providers then they may direct their capital to less efficient and productive companies simply because they can understand the latter's financial statements and thus consider them less risky investments. According to the law of comparative advantage this is a less than optimal solution which makes us economically worse off globally than we could otherwise be. A related rationale for harmonization is that it will enhance comparability of financial statements thus making them easier to use among countries. Wyatt [1989] and Beresford [1990] both point to the need for harmonization in view of the rapid growth in international capital markets and increased cross-border financing. According to them, harmonization is necessary to produce comparable and credible data for use across borders. Beresford, ex-chairman of the U.S. Financial Accounting Standards Board (FASB), rebuts suggestions that the FASB has been "uninterested" and "uncooperative" regarding the international harmonization of accounting standards. He provides his views on how the FASB will participate in the evolution of international standards. The focus is on the positive aspects of internationalization and the FASB's commitment to improving international standards.[13]

Among those that oppose harmonization there are some who consider it to be unnecessary (Goeltz [1991]), and others who are even more critical and view it as being harmful (Fantl [1971]; Samuels and Oliga [1982]; Hoarau [1995]). Goeltz [1991] argues that full harmonization of international accounting standards is probably not practical, nor truly valuable. He opines that global GAAP will not likely be achieved given the institutional impediments in the standard setting process. Also, a well-developed global capital market already exists, so there is no real need to increase the already robust international capital markets. Investors and issuers can make investment decisions without the convenience of international accounting standards. Goeltz's final argument against the need for harmonization is that investors are rational enough to spend the necessary time and money to correctly analyze investment opportunities and focus on real economic results.

Opponents generally cite differences in the economic, political, legal and cultural environment in countries as a justification for financial reporting differences. They typically express concerns that the accounting regimes in developed Western countries

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[12] Walton [1995] and Forrester [1996] point out that harmonization has been a preoccupation of European accountants since the nineteenth century when most continental European countries adopted the Napoleonic Commercial Code.

[13] See Beresford [1990] and [1997] for his views on the FASB's role and participation in the internationalization of accounting standards.

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are likely to dominate global harmonization efforts. Imposing Western accounting practices on developing non-Western countries, they argue, is likely to do more harm than good. Hoarau [1995] is critical about the international accounting harmonization movement based on France's experience with implementing international standards. He contends that in France the influence of international harmonization is limited to consolidated financial statements and that because harmonization disregards the economic, social and cultural context of French accounting it has broken down the homogeneity of the French accounting model, ruptured its unity and reduced the social functions of accounting in France. Hoarau considers the current harmonization process to be synonymous with harmonization to the Anglo-Saxon, and particularly the American, accounting model and its focus on the stockholder as the primary stakeholder. According to him, there remain unanswered questions about the nature and means of achieving harmonization, about its consequences at a national level and about the obstacles and political difficulties to be overcome. Nobes [1995] disagrees with Hoarau's views and refutes a number of points made by Hoarau including the scope of harmonization, alternatives in preparing consolidated financial statements, information needs of creditors and employees, and American 'imperialism' in the harmonization effort. Nobes argues that countries, including France, have adopted certain accounting rules not because of any pressure from the IASC or the U.S. but because they were best suited to those countries' needs in the increasingly international capital markets. In a similar vein, van der Tas [1995] points out that France made certain choices on accounting standards when implementing the Seventh Directive. However, he agrees with Hoarau's view that national standard-setters should be allowed greater involvement in the development of international accounting standards.

We believe that France, unlike a number of the developing countries, has the political will and clout to act in its perceived national interest including in the arena of accounting harmonization. We are concerned, however, that a number of industrializing and economically developing countries that lack the resources to develop their own standards might succumb to the wholesale adoption of IASs in an effort to gain global respectability for their financial reporting. It is our view that such countries should endeavor to make their voices heard in IASC discussions to ensure that their concerns and requirements are considered in any international standards that emerge. Their growing economic prowess gives them the collective ability to do so.

2.3.2 Pressure for and Obstacles to Harmonization

In recent years the pressure for global harmonization has come from a variety of quarters including users, preparers, and regulators of financial statements. Users such as investors and financial analysts are concerned about the reliability and comparability of financial statements prepared in countries other than their own. If they cannot understand the financial statements of foreign companies they may be unwilling to invest in them. As companies increasingly tap foreign sources of capital, this is also a reason for preparers of financial statements to support the harmonization effort. Multinational companies can also expect additional benefits from harmonization such as the reduced cost of preparing consolidated financial statements, ease in monitoring subsidiaries, more relevant managerial accounting reports and comparable performance evaluation methods with harmonization than without it.

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Regulators face higher costs with the growth in cross-border listings by companies since they now need to monitor compliance not just by domestic firms but also by foreign firms that are listed in their jurisdiction. While one way of coping with this might be to simply require foreign firms to provide financial statements that conform to the host country's requirements there is considerable debate as to the wisdom of this approach. Critics such as Baumol and Malkiel [1993], Edwards [1993], and Freund [1993] argue that the high costs of financial reporting and other regulatory compliance thereby imposed on foreign firms causes them to stay away. (Empirical evidence supporting this claim has been discussed in section 2.2 above.) This hurts the very investors that the regulator is mandated to protect by depriving them of attractive investment opportunities. If one accepts this proposition then regulators would also be expected to benefit from harmonization in that it would reduce their monitoring costs and yet allow domestic individual investors the option of investing in foreign companies without incurring unduly high transactions costs.

One of the reasons that global accounting harmony is still an objective rather than a reality is that there remain a number of obstacles to harmonization. Some of these are economic while others are political. On the economic front, harmonization is often opposed due to its economic impact on countries or segments of society within countries. Grinyer and Russell [1992] discuss the lobbying effort in the U.K. in the case of accounting for goodwill and provide evidence that managers and auditors lobbied against the IASC proposal to further their own vested interests. Thus to the extent that economic consequences of accounting practices vary by country and to the extent that they are considered in the standard-setting process this acts as an important obstacle to global harmonization.

Nationalism represents a political obstacle to harmonization. As in many other arenas, countries are wary of ceding control of their accounting regulation to outsiders particularly if it is perceived as replacing their own accounting regulations with those of other countries. It helps if the external standards originate from a multi-country organization such as the IASC since it is more politically palatable for countries to adopt "international standards" rather than the standards of another country. Wallace [1990] discusses the emergence of the IASC as a legitimate organization due to its acceptance by its constituents. According to him, the IASC continues to survive because of (a) the increasing internationalization of business and finance which make global harmonization of accounting and disclosure practices desirable, (b) the composite nature of its standards and its preoccupation with topics of a general nature, (c) its evolutionary strategy, and (d) the absence of a rival organization with keen and prolonged interest in the development and marketing of global accounting standards. However, critics of the IASC have argued that until it undertook its Comparability Project, its standards were so flexible as to be irrelevant and that the IASC was a "Trojan Horse which conceals the Anglo-Saxon accounting enemy inside a more respectable international facade" (Nobes and Parker [1995, p. 127]).

Another political obstacle to harmonization is the absence of strong professional accounting bodies in a number of countries (Nobes and Parker [1995]). This means that an organization such as the IASC, which seeks to operate through national accounting bodies, will not be effective in a number of countries. This obstacle may be overcome, at least as it relates to listed companies, if the International Organization of Securities Commissions (IOSCO) endorses the IASC's standards and provides

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enforcement in its member countries. There are indications that IOSCO may accept this role in the near future [IASC 1997a].

2.3.3 Measures of Harmonization

Harmonization, in the accounting context, may be defined as the process aimed at enhancing the comparability of financial statements produced in different countries' accounting regulations. van der Tas [1988] and Tay and Parker [1990] draw a distinction between material (de facto) and formal (de jure) harmonization. The former refers to the harmony of actual accounting practices while the latter refers to the harmony of financial accounting regulations. van der Tas [1988] draws a second distinction dealing with measurement and disclosure issues. He suggests that the harmonization of both accounting practices and accounting regulations can focus either on measurement issues such as methods of recognition, valuation, and estimation or on disclosure issues such as the level of transparency provided by entities via their financial reporting. Harmonization measurement studies purport to explore the similarity or lack thereof of accounting practices and requirements.

Tay and Parker [1990] analyze six such studies to demonstrate problems involved in measuring the concepts of 'harmonization' and 'standardization' in the context of international accounting. They discuss methodological issues and problems related to the definition and operationalization of terms, data sources, and statistical methods. They draw distinctions between the terms *harmonization and standardization* (i.e., a movement away from total diversity versus a movement towards uniformity), *regulation and practice* (i.e., de jure versus de facto), and *strict* and *less strict* regulation (viz., (i) apply to all companies versus apply to some companies, (ii) the law versus a professional accounting standard, and (iii) defined precisely versus defined loosely to allow discretion). These distinctions were also noted in Meek and Saudagaran [1990]. Finally, they also distinguish between *harmony and uniformity* which are states and *harmonization and standardization* which are processes. They point out that there are numerous differences between how the six studies in their analysis approach their stated task of measuring harmonization and consequently it should not be surprising that they come up with different conclusions.

Tay and Parker [1990] suggest an alternative methodology for measuring harmonization. They make four specific recommendations on how to conduct such research. First, in the interest of comparability the focus ought to be on *de facto* (practice) rather than *de jure* (regulation) harmonization. Second, in the interest of measuring reporting practices they recommend that data be obtained from annual reports or surveys of annual reports rather than surveys of legal and accounting regulation. Third, data on proportions of companies using different accounting practices should be obtained. Then an operational definition of harmonization could be a significance test for differences between the observed distribution of companies using different methods and either a random distribution or some expected distribution. Fourth, the level of harmony could be quantified using a concentration index describing the entire distribution. This would allow comparison over different time periods and provide evidence of harmonization or the lack thereof.[14]

[14] See Gernon and Wallace [1995] for a critique of this area of research.

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2.3.4 Evidence of Current Harmonization

Since the European Union (EU, formerly the European Community — EC) is the only multi-country organization engaged in harmonization that also has the ability to enforce its accounting directives, a number of studies have attempted to measure the level of harmonization attained within the EU. Some of these studies address accounting practice by looking at the extant reporting in corporate annual reports from selected EU member countries while others look at the state of regulation on specific accounting items in selected countries. Hermann and Thomas [1995] look at the level of harmonization in accounting measurement practices among eight member countries in the European Union. Adapting van der Tas' [1988] *I* index to measure harmonization, they find that accounting for foreign currency translation of assets and liabilities, treatment of translation differences, and inventory valuation are harmonized while accounting for fixed asset valuation, depreciation, goodwill, research and development costs, inventory costing, and foreign currency translation of revenues and expenses are not harmonized. They also find some evidence that there is greater harmonization among fairness-oriented countries than among legalistic countries. van der Tas [1992] tests for harmonization of accounting for deferred taxes in the EC and finds mixed evidence for the years 1978-88. Emenyonu and Gray [1992] also use van der Tas's *I* index to measure harmonization of accounting practices between France, Germany and the U.K. They also find little evidence of harmonization across the three countries. Using groups of British and French accountants in a laboratory study, Walton [1992] finds that there is not only a lack of harmonization in the application of the EU Fourth Directive between the two jurisdictions but also a general absence of consensus even within each country group. Garrod and Sieringhaus [1995] compare the regulations for accounting for leased assets in Germany and the U.K. and conclude that the regulations are ambiguous and result in dissimilar accounting treatment in the two countries. Adhikari and Tondkar [1995] study the success of the EU in harmonizing stock exchange disclosure requirements for 11 EU stock exchanges. They find that EU requirements do not eliminate the differences in the disclosure requirements between stock exchanges. Rather they establish a lower bound below which the disclosure requirements may not fall. These studies indicate that the EU has achieved minimal harmony in its accounting practices and regulations (Bindon and Gernon [1995]).

There is a small but emerging literature that addresses accounting harmonization in economic blocks other than the EU. Saudagaran and Diga [1997] study accounting regulation in five countries (i.e., Indonesia, Malaysia, Philippines, Singapore, Thailand) belonging to the Association of South East Asian Nations (ASEAN) in the context of the global and regional paradigms of harmonization. They use a comparative framework to highlight the similarities and differences in the regulatory environment of the five countries. The study examines forces driving global harmonization in ASEAN and discusses the economic and political conditions for regional harmonization that, unlike the EU, do not yet exist in ASEAN. Saudagaran and Diga [1997] conclude that this has led to the dominance of the global paradigm of harmonization in ASEAN. Agami and Monsen [1995] examine accounting standards and practices within Scandinavian countries and find that a fair level of harmonization has been achieved among these countries driven in no small measure by the fact that three (i.e., Denmark, Finland, Sweden) of the four countries (Norway being the exception) are

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members of the European Union. Other studies dealing with the subject of regional harmonization have proposed rather than measured the level of harmony attained among geographically proximate countries. Two such studies are Rahman, Perera, and Tower [1994] and Rivera and Salva [1995]. Rahman, Perera, and Tower [1994] consider the current arrangements relating to accounting standard-setting structures in Australia and New Zealand. They conclude that a merger of the two countries' standard-setting structures would be the most appropriate means of achieving accounting harmony between Australia and New Zealand and offer some ideas to bring about such a merger. Rivera and Salva [1995] propose the European Union model of accounting standard-setting to achieve accounting harmony within Latin America. Among the interesting issues in regional harmonization are 1) whether its effect is to further global harmonization or detract from it, and 2) what factors influence whether countries belonging to economic blocks choose the regional or the global paradigm of harmonization.

Until this point in time there has been very little empirical research measuring the success of harmonization at the global level. Meek and Saudagaran [1990] noted that the research on the extent of harmonization with the IASC's standards, prior to the start of its Comparability Project in 1989, showed that the IASC had little impact on reporting practices even among MNCs. They expressed the view that it was necessary to undertake a systematic analysis of the reasons for the apparent reluctance to adopt IASC standards before setting up enforcement mechanisms for these standards. The need for such research still remains. The less than enthusiastic initial response may be largely due to the fact that the original series of accounting standards promulgated by IASC were very broad and did little to enhance the comparability of financial statements. That particular concern ought to be alleviated to a considerable extent with the tightening of IASC standards through its Comparability and Improvements Project begun in 1989. This project was initiated with a view to enhancing comparability in part to gain the approval and thereby enforcement of its standards by the International Organization of Securities Commissions (IOSCO). Research looking into whether the level of global harmony has increased as a result of the tightening of standards would only be meaningful after the passage of a reasonable period of time since the promulgation of the revised IASC standards.

3.0 DISCLOSURES BY INTERNATIONALLY-LISTED COMPANIES

Meek and Saudagaran [1990] point out that a distinction should be made between the financial reporting practices of domestic and multinational companies. International operations create new stakeholders with new, and possibly different, demands for information. A further distinction can be made for companies raising capital in international capital markets. Additional disclosures, especially of a voluntary[15] nature, can be expected by these companies in response to international capital market

[15] Distinguishing a voluntary disclosure from one that is required is more difficult in an international context that it is in a strictly domestic one. For example, something required in one jurisdiction may be voluntary in another. If an internationally listed company must meet both jurisdiction's requirements, is the item required or voluntary? In addition, disclosures that are required in statutory filings may encourage similar disclosures in, say, company annual reports where, strictly speaking, they are voluntary. Should this disclosure in the annual report be considered voluntary or required?

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pressures associated with the competition for investment funds. Meek and Saudagaran [1990] state that internationally-listed companies are the ones for whom international harmonization efforts are most relevant.[16] However, if voluntary disclosures are already sufficiently harmonized, then the rationale for extensive regulation of transnational financial reporting is less clear. For example, Choi and Levich [1990] report that voluntary disclosures are one way that MNCs cope with international diversity in accounting principles.

Zarzeski [1996] specifically looks at the influence of multinationality on annual report disclosures in relation to so-called "market forces" (leverage and size) and national cultural characteristics. She finds that while cultural attributes underlie disclosure behavior, culture is overridden to some extent by market forces. Specifically, the study finds that a high cultural tendency toward secrecy exerts a general dampening influence on disclosure levels, but that disclosure levels increase as companies grow larger and increasingly multinational, and as they increase their sourcing of finance from stockholders (that is, as leverage decreases).[17] The findings are consistent with observations by Meek and Saudagaran [1990] from research in the early 1980s that reporting by MNCs is anchored in national requirements. Zarzeski [1996] demonstrates that financial statements of MNCs continue to reflect the primary orientation of accounting in their home countries. However, her study is also consistent with the point made above that reporting practices of domestic and MNCs are different. Zarzeski [1996] examines "overall" disclosure levels (i.e., without distinguishing between voluntary and mandatory disclosures) and a refinement would be separating disclosures into voluntary and mandatory items. As noted above, the effects of market forces are likely to be more obvious on voluntary disclosures. In addition, her arguments for why multinationality and leverage should increase disclosure relate more to voluntary than to mandatory disclosures. Finally, note that the study considers the effects of "market forces" generally, not specifically international capital market forces.

Several national studies of corporate reporting behavior have documented an international capital market effect on the extent of voluntary disclosure. Countries include Japan (Cooke [1991]), Malaysia (Hossain, Tan, and Adams [1994]), New Zealand (Hossain, Perera, and Rahman [1995]), and Sweden (Cooke [1989b]).[18] In addition,

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[16] This is in contrast to the official view of the International Accounting Standards Committee, which is that international standards should apply to al companies. Nevertheless, the IASC acknowledges (IASC [1997b]) that its "top priority is to complete the package of 'core' standards required by IOSCO for cross-border listings" (p. 1) Further, the argument about focusing harmonization (and international standards) on certain types of companies is not new. For example, Gray, Shaw, and McSweeney [1981] reason that international standards should be aimed at multinational corporations, while Nobes and Parker [1985, pp. 341-342] argue that harmonization should be aimed at listed companies. Our view that international harmonization is most relevant for internationally-listed companies is based on the assumption that the information needs of capital market participants is the same worldwide. The relevance of internationally harmonized accounting standards for companies that only raise capital in their home country market is less clear (at least to us).

[17] Note that this is opposite of agency arguments that disclosure increases as leverage increases.

[18] Cooke [1991] and Cooke [1992] on Japanese companies are essentially the same analysis, except that the former is concerned with voluntary disclosures, while the latter is concerned with total disclosures (voluntary and mandatory). Both studies examine the same exploratory variables and reach the same conclusions. Similarly, Cooke [1989b] is the same as Cooke [1989a], except that the former is about voluntary Swedish disclosures and the latter is about total disclosures. Again, the same factors are examined in both studies and the same results are found.

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these studies have assessed other factors that explain voluntary annual report disclosures by companies from the countries represented, though they differ in terms of specific explanatory factors examined and some of the results are inconsistent.[19] The only other factor besides international listing status consistently observed across all four studies to explain voluntary disclosures is company size.

Gray, Meek, and Roberts [1995] and Meek, Roberts, and Gray [1995] examine the effect of international capital market pressures on voluntary disclosures by MNCs. Gray, Meek, and Roberts [1995] look at whether internationally-listed U.S. and U.K. MNCs voluntarily disclose more, as well as more harmonized, information in their annual reports than U.S. and U.K. MNCs listed only on their respective domestic stock markets. One innovation in this study is that voluntary disclosure items are grouped by type of information, since there may be differences in disclosure behavior depending on the nature of the information concerned. They form three categories of information: strategic, financial, nonfinancial. Overall, they find that participation in international capital markets is significantly associated with additional voluntary disclosures. However, the effect varies across information type. International capital market pressures are important in explaining strategic information disclosures, but not nonfinancial. For the latter, country effects are observed. Financial information disclosures seem to be weakly influenced by both capital market and country effects, with neither factor dominating. The authors conclude that international capital market pressures exert only a mild harmonization effect on voluntary disclosures.

In Meek, Roberts, and Gray [1995], the authors extend their analysis by including Continental European companies and by examining additional factors beyond listing status and national influences. Additional explanatory factors considered in this study are company size, industry, leverage, extent of multinational operations, and profitability. The study finds that company size, country (or region), international listing status, and, to a lesser extent, industry are the most important factors explaining voluntary annual report disclosures overall. However, as with their other study, the importance of the factors varies by information type.[20] The results point to the importance of distinguishing between types of information in examining voluntary disclosures.[21]

All of the studies discussed in this section so far have focused on disclosures in annual reports. Of course, this is not the only vehicle by which companies reveal information to investors and other interested parties. For example, there are also press releases (including interim and annual earnings announcements), special-purpose

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[19] For example, Cooke [1991] and Cooke [1989b] document a mild industry effect for Japanese and Swedish companies, respectively. The other two studies do not include an industry variable. Hossain, Tan, and Adams [1994] find that ownership concentration is statistically significant for Malaysian companies, but the other studies do not include this variable. Leverage is statistically significant in Hossain, Perera, and Rahman [1995] on New Zealand companies, but it is not in Hossain, Tan, Adams [1994] on Malaysian companies. Neither Cooke paper [1991 and 1989a] considers leverage.

[20] In other words, different types of information are voluntarily disclosed for different reasons. As the authors suggest, this has implications for future research on voluntary disclosures. The existing empirical and theoretical literature has tended to treat voluntary disclosures somewhat generically. This may be one reason why, for example, the single nation studies referred to earlier in this section have some inconsistent results.

[21] One limitation of both papers is that the authors only look at one year's worth of data (1989). Whether their results generalize to other years is not known.

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reports, and formal and informal meetings with financial analysts. Frost and Pownall [1994a] examine a number of types of accounting disclosures made public to U.S. and U.K. securities markets by firms cross-listed in both markets. The disclosures include annual reports, statutory filings (such as with the SEC), and news releases of forecasts and other announcements. They consider both voluntary and mandatory disclosures. Their purposes are to see whether the frequency and timing of such disclosures differ between the two markets, and to relate firms' disclosure practices to factors such as the enforcement of disclosure rules. Generally speaking, disclosures by the sample firms should be comparable in the two markets. However, they find that more, and more timely, disclosures are made in the U.S. than in the U.K., consistent with more stringent enforcement in the United States. The finding is also consistent with higher investor demand for information in the U.S. Frequency and timing is related to firm size and, in the case of the U.S. market, whether firms are on the New York and American Stock Exchanges or on NASDAQ. Finally, they document substantial non-compliance with disclosure requirements in both jurisdictions. Research such as Frost and Pownall [1994a] provide important evidence about transnational information flows that support the functioning of capital markets around the world, and there is scope for additional work such as this. That the U.S. market has a richer information set than the U.K. market means that U.K. investors are, relatively speaking, informationally disadvantaged. Whether this type of market friction affects securities prices is another question. However, a companion study (Frost and Pownall [1994b]) suggests that it may. It documents that the stock price response to earnings disclosures by cross-listed firms is significantly greater in the United States than the United Kingdom, consistent with greater liquidity and more frequent trading in the U.S. The two papers together raise interesting cause-and-effect questions about how enforcement, disclosures, trading, and price reactions interact.

In summary, the research reported in this section suggests that while reporting practices continue to be anchored in national requirements, they should be distinguished for domestic versus multinational versus internationally-listed companies. International capital market pressures result in additional voluntary disclosures, but the effects vary by type of information. At the same time, disclosure requirements are not always met, and companies do not release the same information everywhere, even when they are required to do so. Thus, the pressures for disclosures by internationally-listed companies are quite complex. Finally, international capital market pressures have only a mild harmonization effect.

The role of accounting information in international capital markets and the impact of international capital markets on the corporate release of accounting information are barely understood. Most of the research so far has focused on the most visible forms, namely, the annual report and earnings announcements (the latter are also discussed in Section 4). Yet other forms of communication may be just as or more important. Therefore, there is scope for extending this research into, for example, press releases (other than earnings announcements) and meetings with financial analysts. Moreover, the extent to which disclosures by multinationals and internationally-listed companies is driven by regulation versus user demand (i.e., is voluntary) is an open question. Why, for example, do companies voluntarily disclose some types of information, while at the same time, refuse to disclose certain mandatory items? Both the incentives for and the effects of different types of voluntary information disclosure are also ripe for

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research. For example, proprietary costs have been modeled analytically, but empirical research on their effects on disclosure in an international context is notably absent. Thus questions such as the following await future research: What drives disclosure policy? What channels of communication are used? How do firms coordinate their disclosures across different types of communication? How are disclosures timed and for what reason? These are not easily answered in an international context and securing data is likely to be a significant issue. However, Frost and Pownall [1994a] represents an innovative approach to overcoming the data problem. Case studies and interviews are another approach that can be taken. Then there are questions about the effects of disclosures by internationally-listed companies. For example, how does disclosure policy affect analyst behavior? How do disclosures affect cost of capital? (See Lang and Lundholm [1996] and Botosan [1997], respectively, for recent answers to these two questions for U.S. companies.) Finally, international capital market pressures on disclosure can be expected to grow if the trends toward the use of the increasingly-global capital market continues. In time, we may see them exerting more and more of a harmonization effect on disclosure.

4.0 MULTIPLE GAAP REPORTING

This section deals broadly with multiple GAAP reporting. The subject is divided into three categories, though there is some overlap between the groups. Two developments have spawned this literature. The first is the "discovery" of restatement information in Form 20-F SEC filings by non-U.S. companies. The SEC requires non-U.S. companies with U.S. share listings to include a restatement of income and stockholders' equity to U.S. GAAP in their Form 20-F filings whenever domestic GAAP is used in the primary financial statements.[22] Many companies required to provide restatement information in their 20-Fs also include this information voluntarily in their annual reports. Thus, restatement information can be found in both 20-F filings and annual reports.[23]

The second development is the availability of *Global Vantage*, an international version of the *Compustat* database containing financial statement, market, and other information for companies from over 30 countries. In addition, *Datastream* has price and returns data from the world's major stock exchanges. The use of these two databases has extended traditional capital markets research with a national focus to the international arena. At the time of writing, Meek and Saudagaran [1990] observed that there was almost no research on the impacts of transnational financial reporting on users or on its general usefulness. This is now changed. Sections 4.2 and 4.3 explore the directions the research has taken.

[22] SEC requirements are summarized in such papers as Amir, Harris, and Venuti [1993] and Frost and Lang [1996], and more extensively in works such as Hanks, Farmey, and Walmsley [1992].

[23] Since these companies have already borne the costs of developing restatement information (due to SEC rules), the marginal cost of including it in the annual report is negligible. However, restatements can also be found in annual reports of companies not subject to SEC rules. Some of these (voluntary) restatements are based on International Accounting Standards, not U.S. GAAP. Perhaps these companies provide restatement information in response to capital market pressures or because of a "follow the leader" effect.

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4.1 Descriptions of Alternative GAAP

SEC Form 20-F restatements have been used to analyze GAAP differences between a number of countries and the United States, and they provide a backdrop to the research discussed in Section 4.3. Studies include Weetman and Gray [1990], Weetman and Gray [1991], Hellman [1993], and Norton [1995].[24] These studies use the "conservatism index" developed by Gray [1980] as the focus of their comparisons.[25] Weetman and Gray [1990] examine U.S. GAAP earnings restatements by British companies, and they extend their analysis to Dutch and Swedish companies in Weetman and Gray [1991]. Hellman [1993] examines restatements to U.S. GAAP by Swedish companies, while Norton [1995] compares Australian and U.S. GAAP. Weetman and Gray [1990] and [1991] both find that U.S. GAAP is systematically more conservative than U.K. GAAP. Further, the dominant effects on differences in reported earnings are the result of differing GAAP for goodwill and deferred taxation. Weetman and Gray [1991] find that Dutch GAAP earnings is less conservative, but this is due to the flexibility for income smoothing allowed under Dutch GAAP, rather than any systematic differences between Dutch and U.S. GAAP. For Swedish companies, they report that Swedish GAAP earnings tends to be more conservative than U.S. GAAP earnings, but there is no systematic pattern; the main difference is related to taxation accounting. In contrast, Hellman [1993] finds no support for the notion that Swedish accounting practice is more conservative than U.S. GAAP. Indeed, there is some support that Swedish accounting is less conservative. However, the author noted much variation in differences across companies and over time. Norton [1995] finds little support that U.S. GAAP earnings is more conservative than Australian GAAP earnings. The most important differences involve asset remeasurement, the equity method for investments, and accounting for intangibles. She does find that U.S. GAAP stockholders' equity is more conservative than the amount under Australian GAAP. Overall, the impacts of GAAP differences vary across Australian companies.

Studies such as these are potentially useful for pinpointing differences between U.S. GAAP and that of other countries. Such information might be useful, for example, to investors in assessing differences that exist for other companies from the represented countries not providing a restatement. If the differences are systematic, then it should be possible to develop restatement algorithms. Moreover, the SEC could potentially target the most significant areas of difference for disclosure and forget about the

[24] Cooke [1992] compares Japanese and U.S. GAAP based on a case analysis of five Japanese companies, using a combination of SEC filings and private information provided by the companies. Since Japanese companies use U.S. GAAP in their SEC filings, rather than provide a restatement, this study does not examine restatements per se. He finds some evidence that Japanese GAAP is more prudent than U.S. GAAP. Another study, by Adams, Weetman, and Gray [1993], compares earnings and stockholders' equity under Finnish GAAP to International Accounting Standards. They find that Finnish GAAP is more conservative than IAS overall, but that there are no systematic patterns across companies. They also conclude that there is not enough disclosure to enable a user to restate on his/her own, or even understand the restatements that Finnish firms disclose.

[25] The conservatism index expresses which GAAP's income amount is more (or less) conservative than the other, i.e., which one is lower or higher. With U.S. GAAP as the benchmark, an index value less than 1.0 means that non-U.S. GAAP income is more conservative, while an index greater than 1.0 means that U.S. GAAP is more conservative.

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rest in order to alleviate some of the burden that complete restatement allegedly imposes on companies. Similarly, if the GAAP of some countries are essentially in harmony with U.S. GAAP, then mutual recognition is possible.[26] Unfortunately, the overall findings provide little hope for such uses. There seem to be no systematic patterns; variations are reported across companies within countries and over time. Therefore, restatement algorithms based on past time series (alone) seem likely to be unsuccessful as a tool for predicting future restatements.[27] Moreover, generalizations are probably limited anyway. Firms disclosing restatements (either in compliance with SEC requirements or voluntarily) self-select and are probably not representative of other companies from their home countries. Companies providing restatements conceivably choose domestic GAAP practices that minimize differences with U.S. GAAP.[28] For these reasons, the potential for additional research in this area to yield useful findings seems limited.

4.2 Comparisons of National GAAP

Accounting information plays an important role in the valuation of equity securities traded in stock markets around the world. Yet the purpose of GAAP and financial accounting information varies from one nation to the next. Comparisons of the relationships between securities prices/returns and the accounting information produced by various national GAAP may yield insights to securities markets regulators as to whether to accept accounting information based on another country's GAAP. It should not be surprising if different relationships are observed from one country to the next. Pownall [1993] points out that national stock markets will not necessarily react the same way to similar disclosures. For example, the opportunities for income smoothing vary greatly from one country to the next. Therefore, if earnings are managed differently in different countries, then returns/earnings associations will be different. Furthermore, feeding information to stock markets is not the primary purpose of accounting information in many countries. Returns/earnings relationships are further complicated when one considers that in some countries national GAAP apply at the legal entity level and need not be followed in preparing consolidated financial statements. (As discussed in Mueller, Gernon, and Meek [1997, pp. 64-66], secondary reporting is most often based on IASs or U.S. GAAP.)

Alford, Jones, Leftwich, and Zmijewski [1993] compare the information content of accounting earnings in 17 countries, using the United States as a benchmark. They find differences across the 17 countries, and compared to the United States, both in the

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[26] This idea was behind the proposed reciprocity agreement between the United States and Canada, which was stopped after the SEC learned that, contrary to conventional wisdom, substantial differences exist between U.S. and Canadian GAAP (Bandyopadhyay, Hanna, and Richardson [1994]).

[27] van Offeren [1994] describes a method to restate financial statement amounts for European companies to a common basis. However, it is not designed to restate amounts to the GAAP of any particular country, and some of the adjustments are arbitrary. The method involves analyzing specific financial statement information provided by individual companies for individual years. Thus, it is not a general purpose restatement algorithm. While the author shows that the restatement technique results in significantly different ratios, the usefulness of the restated information is not tested.

[28] One company explained that it does so because U.S. GAAP is "the most accepted benchmark of accounting worldwide" (Warbrick [1994, p. S 113).

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overall information content of accounting earnings and in how quickly it is impounded in prices (which the authors call "timeliness"). They also find that accounting earnings based on the domestic GAAP of four countries - Australia, France, the Netherlands, and the United Kingdom - is either more informative or more timely than U.S. GAAP earnings in the United States. Considering the size and liquidity of the U.S. capital market, the extensive U.S. requirements for timely disclosures, and the effectiveness with which the SEC enforces disclosure requirements, this result would puzzle many U.S. observers (at least), and is not explained by the authors. Pownall [1993] points out that data questions, such as whether earnings is defined consistently across sample countries, also obscure interpretations of the results. Cautious interpretations are in order.

Harris, Lang, and Möller [1994] compare the associations of earnings and stockholders' equity to prices/returns for German and U.S. companies on their respective stock exchanges. They find that the overall explanatory power of earnings on returns is similar for German and U.S. companies, though German earnings are valued at a higher multiple than U.S. earnings, reflecting the more conservative nature of German GAAP. However, they also find that the explanatory power of stockholders' equity on price is significantly less for German companies. Arguably, the most surprising aspect of these results is that German GAAP earnings are just as value relevant as U.S. GAAP earnings. Differences between the two countries in the importance of capital markets as a source of finance, the fundamental purpose of accounting, and particularly German income smoothing practices would lead one to expect lower explanatory power for German companies. The authors claim that this "suggests that German earnings are not as garbled as is often perceived" [p. 207].

Hall, Hamao, and Harris [1994], among other issues, compare returns/earnings associations between Japan and the United States. They find little evidence of an association in Japan, concluding that Japanese investors seem to rely less on earnings and other accounting information when pricing securities than U.S. investors do. Though these results are perhaps not surprising, just what Japanese investor use instead of accounting information is unanswered.

There is scope for extending comparative analyses such as these to other countries, and for further investigation of puzzling results discussed above. How accounting information is associated with securities prices/returns in any country depends critically on that nation's institutional framework, involving the purpose and practice of accounting and the capital market microstructure. Controlling for these differences across countries is difficult, if not impossible. Thus, it behooves the researcher to understand the institutional frameworks and the accounting regulations involved, and to describe them, so others can assess their work. Studies such as these arguably raise more questions than they answer.

4.3 Value Relevance of Restatements

Meek [1991] and Frost and Pownall [1994b] demonstrate that the U.S. stock market reacts similarly to earnings announcements based on U.S. and non-U.S. GAAP.[29]

[29] The reaction is related to the timeliness and frequency of disclosure and to market liquidity. Frost and Pownell [1994b] also find that the same thing cannot be said for the U.K. market. Reactions to U.K. firms' earnings announcements in the U.K. are significant, while reactions to foreign firms' announcements are not.

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Implicit in any restatement disclosure (either in compliance with the SEC requirement or voluntarily) is the presumption that the restatement has relevance to investors over and above accounting information based on the firm's domestic GAAP. Results of a survey by Choi and Levich [1990] indicate that restatement to U.S. GAAP is one approach that institutional investors use to deal with worldwide GAAP differences. The authors also report that the restatement algorithms used by investors are ineffective in dealing with the differences, primarily because corporate disclosures are insufficient for complete restatement. This suggests that it may be difficult for investors to form expectations about U.S. GAAP-based amounts, and given the findings from the descriptive studies discussed above, this would not be surprising. If so, the revelation of U.S. GAAP amounts by non-U.S. firms (in the 20-F or annual report) should provide new (unexpected) information, or have value relevance. Nevertheless, Bhushan and Lessard [1992], based on a survey of investors, conclude that restatements are desirable but not necessary to make informed decisions. The efficacy of restatements is a controversial practical issue. Moreover, there is the long-standing argument of the "single domicile" notion of reporting discussed in Meek and Saudagaran [1990] which attacks restatements on a theoretical basis.[30] The evidence to date has not been overwhelming in supporting the value relevance of restatements. Published papers include Pope and Rees [1992], who look at U.K. companies; Amir, Harris, and Venuti (AHV) [1993], whose sample is a cross-section of companies from 20 countries, excluding Canada (with 40 percent of the sample from the U.K. and roughly 10 percent each from Australia, the Netherlands, and Sweden); Bandyopadhyay, Hanna, and Richardson (BHR) [1994], focusing on Canadian companies; Rees [1995] whose sample is drawn from 17 countries (with roughly one-third of it from the U.K. and one-fourth from Canada); Barth and Clinch [1996], who look at Australian, Canadian, and U.K. firms, Chan and Seow [1996], with a cross-section of companies from 13 countries (and nearly half the sample from the U.K.); and Rees and Elgers [1997], three-fourths of whose sample is from Australia, Canada, and the U.K. (the total number of countries is not reported). Figure 2 presents a summary comparison of the aforementioned studies.

AHV [1993], BHR [1994], and Rees [1995] conduct short window returns tests [31] examining price reactions to the release of restatement information (in the 20-F or annual report). AHV [1993] and BHR [1994] find no price reaction, while Rees [1995] does, both for his overall sample and a separate subsample of Canadian companies. AHV and BHR caution that their (non)results may be due to errors in specifying when the restatement information is actually released. Additionally, short window returns

[30] Foster [1986, pp. 134-136, 153] contrasts the *interactive* and *filter* perspectives of accounting method choice. Briefly, the interactive perspective holds that choices of accounting methods (and other financial reporting decisions) interact with a company's operating decisions, financing decisions, and mix of business decisions. In other words, accounting method choices are not independent of other managerial decisions. In contrast, the filter perspective holds that choices of accounting methods transform ("filter") the results of fixed operating, financing, and mix-of-business decisions into reported financial statement numbers, such as income and assets. In other words, accounting method choices are independent of other managerial decisions. Research supports the interactive perspective, yet restatements rely on the filter perspective of accounting method choice. Frost and Kinney [1996] present evidence that non-U.S. companies enter U.S. capital markets with an overall financial and disclosure strategy.

[31] Daley and Runkle [1996] discuss a number of econometrics and other issues associated with capital markets research which are relevant to the studies discussed here.

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Figure 2

The Value Relevance of 20-F Restatements

		Pope & Rees [1992]	AHV [1993]	BHR [1994]	Rees [1995]	Barth & Clinch [1996]	Chan & Seow [1996]	Rees & Elgers [1997]
	Countries in Sample	U.K.	20 countries, not Canada	Canada	17 countries, including Canada	Australia, Canada, U.K.	13 countries, including Canada	More than 8, including Canada
Type of Test	Price reaction to filing (short return window)	No	Yes	Yes	Yes	No	No	No
	Returns/earnings association (long window)	Yes	Yes	Yes	No	Yes	Yes	Yes
	Market-to-book value/stockholders' equity association	No	Yes	No	No	Yes	No	Yes
	Relative or incremental information content	Relative	Incremental	Incremental	Incremental	Incremental	Relative	Incremental
	Conclusions	Both (U.S. and U.K.) GAAP have value relevance, but neither dominates the other	Mixed	No value relevance	Value relevance	Mixed	Foreign GAAP dominates U.S. GAAP	Restatement information is anticipated

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tests are indicative of the "surprise" value of the restatement. If investors have accurate expectations about the contents of the restatement, then little reaction to its announcement would be expected. However, as noted above, restatement algorithms based on time series alone are unlikely to be successful. Nevertheless, domestic financial statements, interim earnings announcements, and other types of information are available prior to the restatement release which should improve investor predictions. While the evidence on short return window reactions to restatement is therefore conflicting, it should also be noted that the Rees [1995] results are sensitive to the event window specified. When Day t_{-2} is included, the statistical significance goes away. Overall, these studies seem to provide little evidence of an investor reaction to restatement releases.

Long returns windows tests involving returns-earnings associations have also been conducted. Pope [1993] notes that a distinction should be made between the incremental information content and the relative information content of alternative GAAP. The former focuses on the value relevance of the restatement, given domestic GAAP information, while the latter is concerned with which GAAP's information is more value relevant than the other.

AHV [1993] provide mixed evidence of the incremental value relevance of earnings restatements. While the restatement amount is found to be statistically significant in their tests overall, the results seem to be driven by one particular year and by the systems of accounting represented by the countries in the sample (Pope [1993]). The results from the tests by BHR [1994] suggest that the earnings restatement is irrelevant for valuing Canadian companies. Barth and Clinch [1996] find that earnings restatements are incrementally value relevant for Australian and U.K. firms, but generally not for Canadian companies. The Pope and Rees [1992] results indicate that both U.S. and U.K. GAAP have information content alone, each has incremental information content over the other, but that neither one clearly dominates the other. Finally, Chan and Seow [1996], using an approach advocated by Biddle, Seow, and Siegel [1995],[32] compare the relative information content of non-U.S. companies' domestic and U.S. GAAP earnings. They find that foreign GAAP earnings have greater information content than U.S. GAAP earnings.

Besides the earnings restatement, the SEC also requires a stockholders' equity restatement. This restatement has received less research attention, but is where AHV [1993] find their strongest evidence of the (incremental) value relevance of restatement information. Barth and Clinch [1996] also find that the stockholders' equity restatement has value relevance, but, as with the earnings restatement, for Australian and U.K. firms and generally not for Canadian firms.

Summarizing, the empirical evidence suggests the following: (1) non-U.S. GAAP accounting information has value relevance; (2) restatement information seems to have some (though not overwhelming) value relevance, but evidence on the general direction of relevance is mixed; (3) such value relevance as exists seems to vary by country of domicile, or perhaps system of accounting. In other words, the restatement may be more important for some countries that it is for others.

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[32] The procedure involves a pair of three-stage returns/earnings regressions wherein U.S. and foreign GAAP earnings amounts are introduced into the regression sequence in alternating order. One pair "begins" with U.S. GAAP, while the other pair "begins" with foreign GAAP. Relative information content is assessed by comparing third-stage regression coefficients from the pair of regressions.

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As noted above, one reason for the mixed evidence so far on the value relevance of restatements is that investors may be able to anticipate (some or all of) the restatement information through alternative information sources, such as domestic financial statements and interim earnings announcements. This is the premise behind Rees and Elgers [1997]. First-time filers provide shareholders' equity and net income reconciliations for the previous two and three years, respectively. These retrospective reconciliations to U.S. GAAP provide an opportunity to test for the existence of alternative information sources: finding an association between price and retrospective restatements in the periods prior to their disclosure suggests that the 20-F filing is not the exclusive source of this information. This is what Rees and Elgers [1997] find, though they do not identify what the alternative sources of information are.

Overall, the mixed evidence on the value relevance of restatements does not resolve the debate on the efficacy of the SEC's requirement for them. The evidence to date also raises other questions, such as whether restatements are more relevant for companies from certain countries than they are for others. Alternatively, restatements may be relevant for some, but not all companies, regardless of domicile. For example, they may be more informative for small companies or those from certain industries. Thus, there is scope for research aimed at clearing up the mixed results, of which Rees and Elgers [1997] is an example. Further, the relevance of restatements can be assessed using other data besides prices and returns, such as volume and transactions data. There is also a question of whether, and if so how, restatement disclosures affect the way companies are managed. For example, there is anecdotal evidence that Daimler-Benz changed management practices in response to reporting to U.S. GAAP earnings, following its 1993 New York Stock Exchange listing (*Economist* [1994], [1996a], [1996b]). Lowenstein [1996] argues that "you manage what you measure" (p. 1335). So far, research has been framed on the basis of restatements from various non-U.S. to U.S. GAAP. An alternative is to produce secondary financial statements based on International Accounting Standards. These may be even more value relevant than restatements to U.S. GAAP. IAS financial statements seem to be gathering momentum, especially because of anticipated endorsement of IASs by IOSCO (as discussed in Section 2.3). Research on this issue awaits future developments (and data). Also, relevance is but one characteristic of useful accounting information: reliability is another. The integrity of the information (are the standards followed enforced?; is there compliance with the rules?) may matter more than the type of GAAP. Gernon and Wallace [1995] point out that research is needed on whether capital markets even need harmonized accounting information. The theoretical objection to restatements based on the single domicile notion of financial reporting is also unanswered.

5.0 CONCLUSION

During the past decade there have been a number of significant developments in transnational financial reporting including a concerted move to harmonize financial reporting and the change in users' information needs based on the globalization of capital markets. Stakeholders, including stockholders, have become more interested (and invested) in foreign companies, and so reporting issues have gained greater relevance to their evaluation and projection of company performance. In this paper we have extended Meek and Saudagaran [1990] on research in transnational financial reporting

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by providing a review and synthesis of the relevant literature that addresses the major changes in the financial reporting arena.

In the context of developments in the harmonization area, we have examined the causes of diversity in financial reporting, the effects of this diversity and the extant debate over the need for and the optimal model of harmonization. We have also discussed research on regional harmonization particularly in the EU. There are some important questions as to whether harmonization must exclusively occur within the global paradigm which treats regional harmonization as an intermediate step or whether countries perceive regional harmonization as a legitimate alternative to global harmonization based on their particular needs. If the latter view were to gain support, it would have serious implications on current global harmonization efforts centered on the IASC.

As suggested in Meek and Saudagaran [1990], the globalization of capital markets has emerged as a very significant influence in transnational financial reporting. As more and more companies list on foreign stock exchanges there is growing evidence that financial reporting both affects and is affected by the resultant globalization of capital markets. There is growing evidence in the literature that the listing status of companies (i.e., whether and where they have foreign listings) is an important determinant of their financial reporting practices. Financial reporting represents one of the major costs involved in a foreign listing and thus the level of disclosure called for by regulators in different countries is a significant factor in determining the number and type of companies listing in each country. Since this affects the stock exchanges and securities industries in countries, both stock exchanges and securities industries are actively involved in lobbying for that level of disclosure they deem appropriate. Recent studies in this area have examined both mandatory and voluntary disclosure in this context. Related research has also looked at how differing rules on financial reporting items such as goodwill have affected capital market activities in various countries.

The concept of usefulness has begun, and will continue, to play a significant role in transnational financial reporting. The usefulness of alternative as well as multiple GAAP reporting has been a particular focus of recent research. Unfortunately, no clear picture has yet emerged to settle accounting policy debates that encircle the related issues.

As evidenced by the work reviewed in this paper, the international accounting area is dynamic and offers many interesting research opportunities. Global harmonization and the usefulness of financial disclosure will continue to pose important research questions for accounting academics and professionals seeking a better understanding of the interaction between international capital markets and financial reporting by multinational firms.

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