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CHAPTER I
INTRODUCTION

THE PROLOGUE

The technology and information revolutions have transformed economic and political relationships between nations. Due to opening up of the financial markets across the globe, investors have a wide choice of capital markets to invest in. Hence Day [1997:*11*] rightly observes that the international financial system is going through a "paradigm shift that is driven by electronic borderless commerce, financial innovation and longer term changes in consumer needs." Communication technology has advanced so far and so fast that it has given new meaning to the expression, "it's a small world" [Beresford: 1990,*107*]. Consequently, the global investor must have to access information about the performance of any company, in any market that he or she chooses to invest in. However, differences in language, accounting practices, and reporting requirements in various countries render performance reports by many companies rather investor-unfriendly. But the strength of a global company lies in its ability to access high quality capital at the lowest cost from a global pool of investors. Such companies study the needs of global investors and publish financial information in a language and form understood by their existing as well as prospective investors. In the process, financial statistics may have to be restated and financial terminology may need to be translated. This trend has led to a new accounting discipline of international financial reporting. According to Haskins, et., al; [2000:*2*], "International financial reporting is a dynamic, evolving field of enquiry. Powerful new technologies and communications devices have opened the world for an explosion in cross border commerce and capital creation. Never before has there been so much pressure on, and opportunity for, leaders of financial reporting thought to help shape the most useful "language" by which suppliers of capital and seekers of capital communicate across companies, industries, countries, and cultures."

Hence a key issue in international financial analysis is the restatement and translation of financial reports that describe operations conducted in one environment, but which are the subject of review and analysis in another environment. This necessitates the uniform global accounting rules. Hence Macdonald [1998:*1*], a columnist with the Wall Street Journal writes: "It sounds inviting: a single, unified set of international accounting rules that corporations anywhere can use to list on any stock market on the planet."

Accounting practices have, however, evolved differently through history in different countries due to variations, for example, in economic development, cultural background and political situations. In order to meet the needs of the increasingly globalized business community, financial information has to be easily accessible, reliable and simple to understand. A similar set of rules and standards would make comparison easier for users, as well as facilitate the work of accountants and make the life of the international companies less complicated.

ACCOUNTING AS AN INFORMATION SYSTEM

The Committee on Terminology [AICPA: 1953, p*ara.9*] formulated the following definition: "Accounting is the art of recording, classifying and summarizing in a significant manner and in terms of money, transactions and events which are, in part at least, of a financial character, and interpreting the results thereof." The American Accounting Association (AAA) [1966,*1*] defined accounting in these words: "Accounting is the process of identifying, measuring and communicating economic information to permit informed judgments and decisions by users of the information." Further, the AICPA [1970, *para. 40*] defined accounting as an information system in these words: "Accounting is a service activity. Its function is to provide quantitative information primarily financial in nature about economic activities that is intended to be useful in making economic decisions."

Today, the business community has admitted that the accounting is "the language of business." They are using accounting to communicate the existence and the evolution of the financial situation and also of the performance of the economic entities. Financial information is a form of a language. And if the language of financial information is to be applied to use, so that investment and credit decisions can more readily be taken, it should not only be intelligible, it should also be comparable. Accounting information is the data used for decision-making and is dependent on how the accountant collects and organizes the raw data for final transformation into information [Iqbal et. al.,: 1997]. An accounting information system is a system and its purpose is to identify, collect, measure, and communicate information about economic entities to those with an interest in the financial affairs of the enterprise [Dyckman: 2001,*4*]. The persons, who have interest in the entities, may be either external or internal decision makers. External decision makers are those who lack direct access to the information generated by the internal operations of a company. They use accounting information in deciding on matters such as whether to invest in the entity, extend credit to it, or even do business with it. Internal decision makers are the managers of an entity and they will use the information for taking internal decisions of the business. External users are typically not in a position to demand specific financial information from the entity; rather they must rely on general-purpose financial statements. To meet the general information needs of external decision makers, the accounting profession has developed a body of financial accounting concepts, principles, and procedures intended to ensure that external financial statements are relevant and reliable. This body of concepts, principles, and procedures is known as Generally Accepted Accounting Principles [GAAP]. The term, 'Generally Accepted', reflects the development of accounting theory as the result of social choices

DIVERSITY IN FINANCIAL REPORTING

The character of accounting principles and practices as social choices 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 expected always. Accounting diversity among societies is reflected in financial statements prepared under different accounting standards.

The thrust of international financial reporting is on harmonization. In this regard Hulle [1993:*2*] asserts that "The objective of harmonization is the comparability of accounts." With all the progress made towards harmonization of financial reporting at the international level, the diversity still continues unabated. Table 1.1 provides a glimpse of diversity for selected countries consisting of the United States, United Kingdom, Germany, Hong Kong and India. The accounting items included asset valuations, inventory valuations, year end inventory valuations, depreciation, research and development costs, deferred income taxes, pension liabilities and statement of cash flows. A quick perusal of the accounting methods adopted for these eight accounting items in these countries reveals that accounting diversity still persists.

TABLE 1.1
DIVERSITY IN ACCOUNTING PRACTICES

COUNTRY	SL. NO.	ITEM	ACCOUNTING METHODS
USA	1	Asset Valuation	Historical cost with selected revaluation
	2	Inventory Valuation	Principally LIFO (because of tax consideration); also FIFO and average cost methods.
	3	Inventory: year-end	Lower of cost or replacement cost.
	4	Depreciation	Principally straight line with accelerated and production methods permitted.
	5	Research and Development Cost	Research costs expensed currently; development costs expensed currently except in certain industries.
	6	Deferred Income Taxes	Computed under liability method.
	7	Pension Liabilities	Reflected on balance sheet.
	8	Statement of Cash Flows	Required.
UK	1	Asset Valuation	Historical cost with revaluation adjustments permitted.
	2	Inventory Valuation	Principally FIFO and average cost methods; LIFO not permitted for tax purposes, hence rarely used.
	3	Inventory: year-end	Lower of cost or net realizable value.
	4	Depreciation	Principally straight line with accelerated methods permitted.
	5	Research and Development Cost	Research costs expensed as incurred; development costs may be capitalized under limited situations.
	6	Deferred Income Taxes	Computed under liability method, with management able to avoid its booking if not reasonable to assume it will be payable in foreseeable future (a partial provision method)
	7	Pension Liabilities	Reflected on balance sheet.
	8	Statement of Cash Flows	Required.

Contd.,

GERMANY	1	Asset Valuation	Historical cost, applied conservatively
	2	Inventory Valuation	Principally specific identification or moving weighted average method; FIFO and LIFO permitted, although rarely used.
	3	Inventory: year-end	Lower of cost or replacement cost.
	4	Depreciation	Straight line, accelerated methods, and production based methods permitted; excess (or extraordinary) depreciation based on tax code permitted and frequently used.
	5	Research and Development Cost	Principally expensed as incurred.
	6	Deferred Income Taxes	Largely unnecessary due to close conformity of book and taxable income; when present, often not disclosed.
	7	Pension Liabilities	Reflected on balance sheet and likely to be an amount equal to the accumulated benefit obligation.
	8	Statement of Cash Flows	Required (after 1998).
INDIA	1	Asset Valuation	Principally historical cost with selected revaluation (i.e., fixed assets) usually on basis of independent appraisal.
	2	Inventory Valuation	Principally FIFO, average cost, or LIFO; specific identification and standard cost methods permitted.
	3	Inventory: year-end	Lower of cost or net realizable value.
	4	Depreciation	Principally straight line and declining balance methods; excess depreciation due to revaluation recovered from the revaluation reserve.
	5	Research and Development Cost	Charged to expense as incurred, except costs associated with products for which (1) costs clearly identified, (2) technical feasibility demonstrated, (3) management intent to produce and market, (4) costs likely to be recovered, and (5) resources exist to produce and market.
	6	Deferred Income Taxes	Generally the flow-thru approach used when no deferred taxes arise; liability method recommended.
	7	Pension Liabilities	Disclosed on balance sheet i since most currently funded for tax consideration.
	8	Statement of Cash Flows	Permitted but not required.
G K	1	Asset Valuation	Principally historical cost with revaluation of

Contd.,

			non-current assets permitted.
	2	Inventory Valuation	Principally FIFO and average cost.
	3	Inventory: year-end	Lower of cost or net realizable value.
	4	Depreciation	Principally straight line and declining balance methods; other methods permitted.
	5	Research and Development Cost	Currently no prescribed accounting standard.
	6	Deferred Income Taxes	Computed under the liability method.
	7	Pension Liabilities	Currently no prescribed accounting standard.
	8	Statement of Cash Flows	Required using either direct or indirect method.

Source: Haskins et. al.,[2000]. pp. 451 and 506-515 (edited).

If investors and creditors encounter difficulties in understanding financial statements, they would be reluctant to invest or lend funds to such companies [Schroeder et. al.,:1995]. Therefore, it is imperative for financial reports to be written in a common accounting language that is understood globally [Pacter: 1998]. In addition, globalization of business, foreign currency exchanges, and the need for consolidated financial statements are exerting tremendous pressure on the internationalization of accounting standards. Anderson [1993] stated that "An international set of accounting standards would allow a more level playing field because income statements and balance sheet ratios would become more consistent between competing companies." Adhikari and Tondkar [1992:*76*] reported: "Financial accounting reporting and disclosure standards and practices do not develop in a vacuum but reflect the particular environment in which they are developed." Accounting principles and practices are generally influenced not only by environmental factors such as history, values and culture, but also by the stage of that society's economic development and accounting system. If accounting is the language of business, then this language becomes relevant when it is easily understood and satisfies users and decision makers. Number of studies have been conducted to identify the reasons explaining accounting diversity [Gray: 1988; Cooke and Wallace: 1990; Doupnik and Salter: 1995]. Meek and Saudagaran [1990] and Iqbal [2002] identified five key major environmental influences relating to the economic system, the political system, the legal system, the educational system, and religion. In particular, the level of inflation, sources of finance, the stage of economic development, financial markets, and managerial development or sophistication, accounting education, and culture affect accounting practices [Meek and Saudagaran:1990; Gernon and Meek: 2001]. Iqbal [2002] argues that the "degree of economic risk exposure to the investors and creditors in a country is directly related to the degree of economic instability of the country." In countries characterized by an unstable economy, economic forecasts are very difficult and require constant, if not drastic, changes leading to questionable accounting practices. Therefore, a stable economy facilitates the development of a conceptually sound accounting system.

EFFECTS OF DIVERSITY

Many studies have shown that diversity in financial reporting practices around the world affects firms in many areas. The studies by Biddle et. al. [1991]; Saudagaran et. al. [1992 and 1995]; and Cheung et. al. [1995] conclude that differences in disclosure levels affect a firm's decision to list on a foreign stock exchange. Choi and Levich [1991] and Bhusan and Lessard [1992] study the effects of regulatory differences on user groups and find that accounting differences are important and affect the capital market decisions of capital market participants. Similarly Choi and Levich [1991]; Lee et. al. [1992]; Dunne and Ndubizu [1995] observe the effects of differences in the treatment of goodwill on mergers and acquisitions.

Saudagaran et. al. [1995] finds that the probability that a firm will list its securities on a foreign exchange is inversely related to the foreign exchange's disclosure level and directly related to that firm's exports to the foreign exchange's home country. Therefore, the less diversity in financial reporting across borders, higher is the probability that a firm will want to list its securities on a foreign exchange. In 1990, Beresford, then chairman of the Financial Accounting Standards Board (FASB), expressed his concerns as follows: "It is widely reported that many foreign companies are reluctant to offer their securities in the U.S. public markets or list them on U.S. exchanges because they are unwilling to comply with the voluminous and detailed U.S. accounting and disclosure requirements or submit to the SEC's jurisdiction. This is said to put the U.S. exchanges and securities industry at a competitive disadvantage."

Differences in accounting practices affect users of financial information. Choi and Levich [1991] find that diversity in accounting affects capital market decisions (such as the geographic spread of investments, the types of securities selected, and information processing costs) of a significant number of market participants regardless of nationality, size, experience, scope of international activity, and organizational structure. Perhaps a quick solution to alleviate the problem of accounting diversity for users would be to restate foreign accounting information. However, according to Choi and Levich [1991], restatement alone is insufficient to do away with accounting diversity. Choi and Levich [1991] likens the harmony and coordination of national accounting policies to "apple pie and motherhood" arguing that this promotes economic welfare. Of particular interest was the fact that in Choi and Levich's [1991] study, approximately 50 per cent of the companies surveyed felt that accounting diversity affected their capital market decisions. The other 50 per cent responded that accounting diversity did not affect them either because they employed coping mechanisms or simply because they thought that accounting diversity was not an issue. Thus, because of the ambivalence found in these results, it can be argued that accounting diversity does have necessarily negative behavioral effects on a variety of users. Choi and Levich [1990] also found that accounting differences significantly affected a firm's capital market decisions. According to them, nationality seemed to play an important role in issuer behavior. They conclude that since U.S. and U.K. firms have to comply with fairly high disclosure standards at home, they appear to have greater flexibility in tapping international capital markets. This is in sharp contrast to German, Japanese, and other firms that provide less transparent financial statements.

EFFORTS TO OVERCOME DIVERSITY

Existing cross-country diversity in financial reporting has negative implications for the globalization of capital markets. It acts as a barrier for companies to gain access to foreign capital markets and increases the cost to investors of adding foreign companies to their investment portfolios [Choi and Levich: 1991]. Accounting diversity will probably be very difficult to eliminate completely. National sentiments and pride are embedded in the consciousness of every people. Such traits have existed for centuries and are passed on from one generation to the next. Indeed, the efforts to minimize diversity in accounting are laudable but perhaps the reality is that the international community will have to live with such accounting diversity. As Haskins et. al. [2000:*1*] state: "Never before has there been so much pressure on, and opportunity for, leaders of financial reporting thought to help shape the most useful 'language' by which suppliers of capital and seekers of capital communicate across companies, industries, countries, and cultures." Efforts to reduce this diversity and harmonize financial reporting internationally have been underway for more than four decades [Choi et. al.: 2002]. Saudagaran et. al. [1997] argues that pressure from international capital markets is likely to be one of the main reasons for moderating accounting diversity in the future. They further state that there are two main avenues of achieving accounting compatibility. The first is through standardization and the second is through harmonization.

THE CONCEPTS

Nobes [1992] observes that it is presumably not an easy word to define, as neither the European Commission nor other organs of the commission have explicitly defined the concept of accounting harmonization. The primary motive for the harmonization of accounting systems across all the Community Member States as stated in Article 54 Paragraph 3 g of the Treaty is to "reach an economic equal level playing field within the Community" [Haller 2002:*155*]. This is in terms of freedom of formation and equivalent levels of protection for shareholders, employees and creditors across Member States [Roberts: 2002]. The overall aim could be seen as one, which facilitates intra-community trading and financial transactions and hence contributing to free trade and free movement of capital within the Communities [Roberts: 2002].

Harmonization seeks to reduce the variety of accounting choices and to make them more comparable. Nobes and Parker [1991:*329*] believe that harmonization is a process of reducing alternative accounting choices and increasing the uniformity of accounting practices. Meek and Saudagaran [1990] argue that harmonization involves a conciliation of various points of view, thereby avoiding logical conflict. This degree of harmonization does not prevent the existence of choices between different accounting practices. A similar view of harmonization has expressed by Tay and Parker [1992:*218*] who stressed that there should be flexibility within harmonization. Van der Tas [1992:*212*] recognizes the importance of a uniform set of accounting rules, but acknowledges their 'less strict' character. According to Samuels and Piper

[1985:*56-57*], the international harmonization of accounting has been defined as "the attempt to bring together different systems. It is the process of blending and combining various practices into an orderly structure, which produces [a] synergistic result."

Harmonization leads to the removal of alternative methods, and the maximum harmony is achieved when all firms adopt the same accounting treatment [Van der Tas 1988 and 1992a; Emenyonu and Gray 1992 and 1996; Archer et. al., 1995; Herrmann and Thomas 1995; Adhikari and Emenyonu 1997; Canibano and Mora 2000; Murphy 2000; Pierce and Weetman 2000; Aisbitt 2001; Parker and Morris 2001]. To Meek and Saudagaran [1990:*169*], harmonization 'implies a reconciliation of different points of view and permits different requirements in individual countries as long as there is no logical conflict,' while Nobes [1998: *117*] defined, harmonization as 'a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation.' Wolk et. al., [2001] describe harmonization of accounting standards as "the degree of co-ordination or similarity among the various sets of national accounting standards and methods and formats of financial reporting." A similar definition we find in Roberts et. al., [1998] who describe harmonization as "a process by which accounting moves away from total diversity of practice." Haskins et. al., [1996] define international accounting harmonization as "the process of bringing international accounting standards into some sort of agreement so that the financial statements from different countries are prepared according to a common set of principles of measurement and disclosure." Van der Tas [1988:*157*] describes harmonization as a coordination, a tuning of two or more objects. Users are confronted with several financial reports. It would be useful for them if these financial reports were more in harmony. Therefore, financial reports are a target of harmonization. One way to harmonize financial reports is to formulate standards.

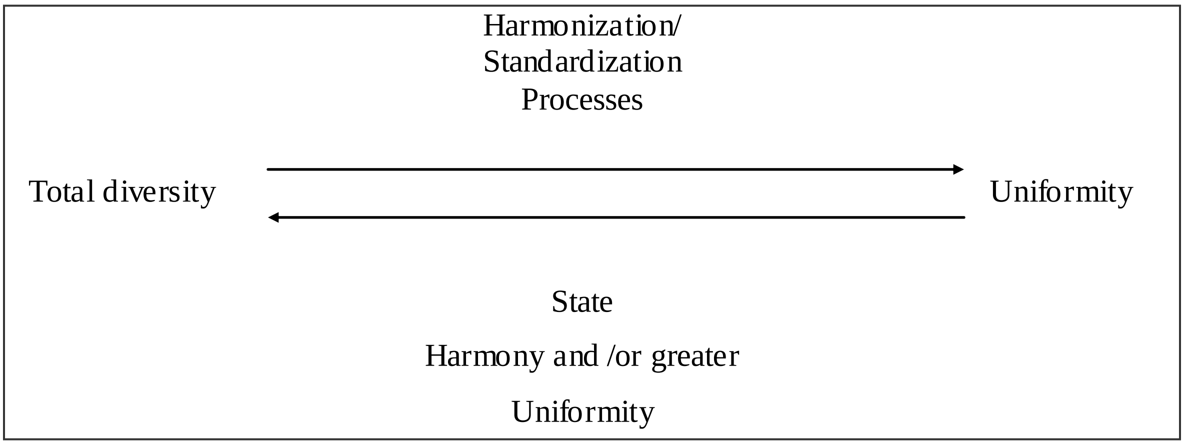
Standardization is defined as "a strict adherence to one set of rules to achieve uniformity in practices [Tay and Parker 1990; Van der Tas 1988]." It is a period of uniformity or near uniformity. Standardization is more ambitious than harmonization. This is because standardization implies the adoption of a unique set of accounting rules, with universal application. As argued by Choi and Mueller [1984: *470*; 1992: *257*]; Samuel and Piper [1985: *56*] and Canibano and Mora [2000: *351-352*] standardization is the ultimate goal of the International Accounting Harmonization (IAH) process. As Tay and Parker [1992:*218*] point out that accounting choice would not exist in a period of standardization.

The ultimate definition of harmonization comes from Van der Tas [1988:*158*]. He defines: Materially measurable harmonization is an increase in the degree of comparability and means that more companies in the same circumstances are applying the same accounting method to an event or giving additional information in such a way that the financial reports of more companies can be made available. Hence harmonization 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.

HARMONIZATION Vs. STANDARDIZATION

Harmonization, standardization, and uniformity are the terms that are used in the literature synonymously. There is no real difference among them other than, perhaps, in the degree of harmonization they involve. In each case, the terms used refer to the efforts required to ensure that similar transactions and events are Accounted in a uniform way wherever they take place or are reported [Uddin: 2005]. "Standardization" implies uniform standards in all the countries involved. "Standardization" is also a process, a movement towards uniformity, which is also a state [Tay and Parker 1990; Nobes and Parker 2000]. However, "Harmonization" implies a reconciliation of different points of view, and permits different requirements in individual countries to be reported in a uniform way provided that there is no logical conflict [Canibano and Mora: 2000]. Further, harmonization is a process, a movement towards harmony, towards the application of IAS/ IFRSs that is a state [Uddin: 2005]. Figure 1.1 presents the clarity of thought on the concepts of harmonization and standardization.

FIGURE 1.1
HARMONIZATION/STANDARDIZATION



Soruce: Tay & Parker, [1990: *73*]

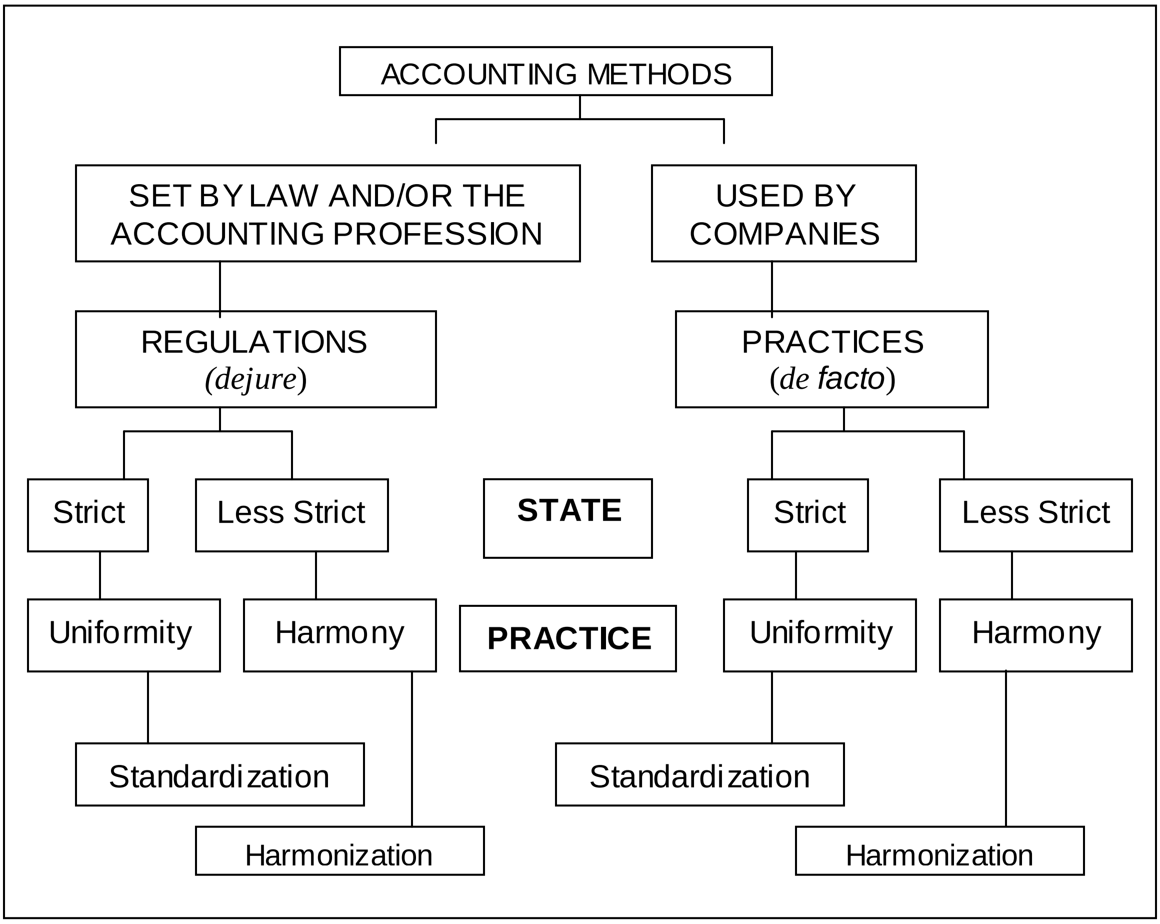
HARMONY Vs. UNIFORMITY

Harmony can be defined as a state in which a certain degree of co-ordination exists between two or more subjects. Harmony should not be seen as synonymous with rigid uniformity [Van der Tas: 1988, *159*]. Tay and Parker [1990:*73*] defines harmony as a clustering of companies around one or a few available accounting methods, and harmonization as a movement away from total diversity of accounting methods. Harmony is a state measured at a point of time, whereas harmonization is a process measured by comparing harmony at different times [Emenyonu and Gray:

1996]. Van der Tas [1988:*157*; 1992a: *1*] defines harmony as the correspondence between two or more objects at a particular point in time; and harmonization as an increase in harmony, that is coordination or tuning of two or more objects. Murphy [2000] summarizes: "… harmonization is a process. Harmony is a state, which will also be referred to as a level. When the degree of concentration for an accounting method increases, the state of harmony increases and harmonization has occurred."

Wilkinson [1965:*11*] defines accounting uniformity as "each company presents only one set of accounts for all investors, of whatever nationality." According to Tay and Parker [1990:*74*] accounting regulations may be strict or

FIGURE 1.2
TERMINOLOGY OF HARMONIZATION AND STANDARDIZATION



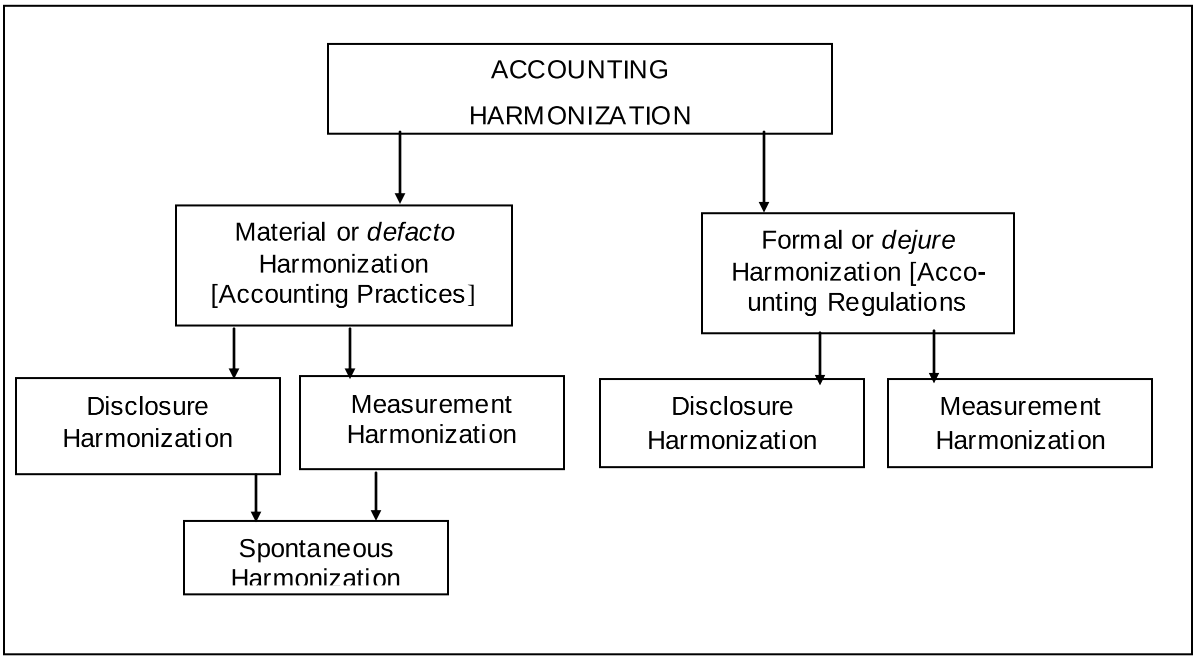
Source: Tay & Parker [1990:*74*]

less strict in three different senses. First, a regulation may apply to all companies (strict) or only to some companies (less strict). Second, a regulation may be contained in the law (strict) or in a professional accounting standard (less strict). Compliance with a legal regulation may be expected to be higher than compliance with a standard. Third, a regulation may contain a precise definition (strict) or a discretionary one (less strict). All three senses of the terms 'strict' and 'less strict' imply that the former is associated with uniformity, the latter with harmony. It is shown in the Figure 1.2.

TYPES OF HARMONIZATION

Based on accounting regulations and practices, harmonization has been classified into two types: (a) *de jure* and (b) *de facto* harmonization. According to Tay and Parker [1990], *de jure* harmony refers to the extent that regulations in company's acts, accounting standards, etc. are aligned, and *de facto* harmony refers to what companies actually do, that is to their disclosed accounting practices [Parker: 1996, *317*]. Alternatively, Van der Tas [1988: *158* and 1992a] categorized, it as: (a) Formal, (b) Material and (c) Spontaneous harmonization. According to Rahman et. al.,[1996], formal

FIGURE 1.3
THE CONCEPT OF HARMONIZATION



Source: Canibano & Mora [2000: *352*]

harmonization is the harmonization of regulations; material harmonization refers to accounting practices as influenced by regulations or by market forces; while spontaneous harmonization arises from market forces and not from regulations. *De jure* harmony and formal harmony are equivalent terms, as are material harmony and *de facto* harmony, while spontaneous harmony is a subset of material harmony. Figure 1.3 highlights the accounting harmonization from the viewpoint of *de jure* and *de facto* harmonization mainly.

BENEFITS OF HARMONIZATION

There are a number of benefits which can be derived from the harmonization of accounting standards. The possible benefits which may be derived from it include: facilitating international transactions and minimizing exchange costs by providing increasingly perfect information; improving financial market information [Weber: 1992; Turner: 1983]; exclusion of certain unfamiliar or misleading practices and narrowing the range of acceptable alternatives across countries [Dan and Sandra: 1992]; easier consolidation of foreign accounts for multinational companies; comparability of financial statements of firms in different counties for investment and credit analysis [Turner: 1983]. Greater staff mobility in public accounting firms, and the appraisal of foreign companies for potential takeovers would also be facilitated. Furthermore, Kenneth [1994] claims that the allocation or resources in a global capital market will facilitate improved social control over global corporations. Thorp [1990] gives three exclusive benefits of harmonization e.g. reducing administrative and system costs; smoothing business communication processes and lessening ambiguity in the interpretation of financial data; and facilitating better information for centralized agencies.

Choi et. al., [2002] argue, "Financial statement users have difficulty in interpreting information produced under non-domestic accounting systems. They claim that harmonization will make it more likely that users will interpret the information correctly, and thus make better decisions based on that information." Some investment institutions [that is, users] have attempted to develop "translators" that convert financial statements prepared under one set of GAAP to another [Choi and Levich: 1991]. Barth and Clinch [1996] are attempting to develop computer algorithms to translate Australian financial statements into their UK, US and Japanese

GAAP equivalents. This could be avoided if one set of accounting is followed in global level.

Peirson and McBride [1996] highlight the benefits on investors' perspective and cost aspect. Hence they perceived the following benefits: (1). Harmonization would allow investors in international capital markets to have access to better quality information as a result international investment would be expected to be encouraged, (2) International harmonization of accounting standards would simplify the reporting requirements for multinational companies and hence would reduce the cost of complying with financial reporting requirements.

Macdonald [1998:*1*] argues if international rules were accepted everywhere, investors avoid the need to go through the "Statistical log surrounding country by country accounting rules" which simplifies 'tracking' the true earnings power of foreign companies. This will enable both little individual investors and institutional investors to buy foreign stocks cheaply. The New York Stock Exchange (NYSE), like any other Stock Exchange around the world, supports the application of international standards for it would "profit from additional foreign listings."

Turner [1983] observes that the greatest benefit that would flow from harmonization would be the comparability of international financial information. Such comparability would eliminate the current misunderstanding about the reliability of foreign financial statements and remove one of the most important impediments to the flow of international investment. The accountancy profession itself would definitely benefit greatly by harmonization since this process would make auditing easier and less time consuming. Other groups that may also benefit from harmonization are, for instance, tax authorities that need to consider differences in the measurement of profit when dealing with foreign incomes and labor unions that have to cope with multinational employers [Nobes and Parker: 2000].

NEED FOR THE STUDY

In the present business scenario, companies are converging with globalization, and they invariably need to follow uniform accounting procedures, which can be understood by the entire business community. The environmental factors of the global economy, the international monetary system, the emergence of multinational corporations and foreign direct investment create an environment in which business transactions and their finalization measurement and disclosure take new and distinctive form that calls for a specific accounting sub-discipline or the harmonization of accounting practices. For many years, there has been an effort to harmonize accounting standards and several international accounting organizations and other concerned institutions have been attempting to reduce the differences in financial reporting diversities across countries and within their countries among the corporate entities. The International Accounting Standards Board (IASB) has led this attempt, since its formation in 1973. Its objective is to "work generally for the improvement and harmonization of regulations, accounting standards, and procedures relating to the presentation of financial statements through improving the quality of financial statements and to increase the degree of comparability." Other organizations such as the International Federation of Accountants (IFAC), the International Organization of Securities Commission (IOSCO), the Financial Accounting Standards Board (FASB), the Organization for Economic Co-operation and Development (OECD), the European Community (EC) etc., also have been working to achieve the same objective. At the national level, almost all countries have their own professional accounting bodies, which have promulgated accounting standards to achieve this objective.

The Institute of Chartered Accountants of India (ICAI) shoulders the responsibility of setting standards in India on the lines of International Accounting Standards (IASs). With all these endeavors, little has been done to devise a way of quantitatively determining the extent to which such efforts have been successful in achieving harmonization in developing countries [Emmanuel et. al.: 1992, *49*]. However, moderate attempts being made to measure the effectiveness of accounting standards on harmonization abroad*, no such efforts are discernible in the Indian context. Hence this study attempts to measure quantitatively the extent of harmonization achieved in complying with accounting standards in Indian corporate sector.

OBJECTIVES OF THE STUDY

In carrying out the study, the following objectives have been identified:

(i) To understand the conceptual background of harmonization;

(ii) To analyse the financial reporting practices in India;

(iii) To measure the harmonization level in Indian corporate sector;

(iv) To test the relationship between age, size, performance level, operational level, type of sector and equity base and the harmonization level;

(v) To identify the problem areas in financial reporting harmonization; and

(vi) To offer suggestions to improve financial reporting environment in India based on the findings of the study.

HYPOTHESES FOR THE STUDY

In carrying out the study, the following hypotheses have been identified.

H1: Mandatory accounting standards have increased the harmonization level in India;

H2: There is a positive relationship between age of the companies and harmonization level;

H3: There is a positive relationship between financial performance measured in terms of profit level and harmonization level;

H4: There is a positive relationship between ownership equity and harmonization level;

H5: Harmonization level is higher in multinational companies than uni-national companies; and

H6: There is a positive relationship between type of industrial sectors and harmonization level.

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* Chapter IV-Review of Literature, pp. 120-193

RESEARCH METHODOLOGY

The study relies mainly on the secondary sources of information drawn from the reporting practices found in the annual reports of the Indian listed companies. In this regard, Tay and Parker [1990:*84*] observe: "If harmonization activities are the result of concerns about the comparability of accounts produced by companies from different countries, then a measurement study should focus on actual reporting practices rather than regulations." Further, they opine that actual reporting practices might be assessed most accurately from annual accounts, or detailed surveys of such accounts. Thus the appropriate data sources would be published accounts, or national surveys based on samples of company accounts rather than surveys of legal and professional accounting regulation. They also favor the using of concentration index to measure the level of harmony and suggest that the evidence of harmony would be the existence of a significant difference between the observed and expected distributions, as measured by some appropriate significance test, for example, chi-square.

Keeping in mind the suggestions extended by Tay and Parker, the data used in this study were culled out from the annual reports of 104 listed Indian companies (listed in Appendix-1) selected on random basis for three years (1996-97; 2003-04 and 2005-06). These three years were deliberately selected to test the hypotheses, because the majority of accounting standards in India became mandatory between 1996 and 2004. To ensure effective measurement of harmonization, only those companies with a primary or significant interest in manufacturing activities were included, because manufacturing companies disclosed more information than non-manufacturing firms [Cooke: 1992]. Apart from this, the manufacturing firms face more number of reporting problems than the other types of firms. Thus the companies engaged in banking, insurance service, extractive work, property development and investment companies were excluded from the survey.

The sample companies were selected randomly, so as to guard against any biases. Companies were selected randomly from the list of companies found in Fortune India (Business Magazine for Business, Finance and Investment) database. Addresses of these companies were collected from the websites of the respective companies and of India Infoline company information data base (http://www.indiainfoline.com/comp/comp_index.asp). Totally, 300 companies were identified and were requested to send their annual reports for the years, 1996-97, 2003-04 and 2005-06 stating the research objectives as the background information. The response from these companies was not overwhelming. A few companies had sent only one year's latest annual report and yet some of them had honestly responded their inability to send previous years' annual reports due to non-availability in their record. Totally, 104 companies responded positively by sending their annual reports for all the three years. Thus the response rate was 34.67 per cent. Accordingly, 104 companies were included in the study on the basis of purposive quota sampling and the availability of annual reports for the above years except for the year 1996-97, for which year the annual reports were available only for 102 companies. Totally, the sample included 40 companies engaged in consumer durable goods, 30 companies engaged in intermediate goods industries and 34 companies engaged in manufacturing basic and capital goods. Out of these 104 companies, 58 companies were uni-national companies and 46 companies were multinational companies.

The accounting items to study harmonization included in this research were only measurement issues and disclosure issues were considered sparingly based on relevance of such issues. However, the measurement issues were considered based on two criteria: firstly, measurement issues must significantly affect measures of net assets and/or profits; and secondly, information relating to the particular method adopted for treating each of the variables was commonly available from the section on 'Notes to Accounts' of most companies' annual reports.

The accounting issues selected to measure harmonization numbered nine, which included inventory valuation method, inventory costing method, depreciation method, treatment of research and development costs, valuation of tangible fixed assets, treatment of borrowing costs, treatment of taxation, investment valuation method and treatment of foreign exchange transaction. These dependent variables were included in the study because of two reasons: (i) the ICAI [2003:*39*] observes that valuation of inventories, valuation of investments, valuation of fixed assets and conversion of foreign currency items are writ large with a number of accounting measurement and disclosure policy choices; and (ii) the perusal of the annual reports of the 104 selected respondent companies revealed that there were different accounting measurement and disclosure policy choices with regard to barrowing costs, research and development costs and taxation.

Further, these variables selected for testing were chosen because they could in solo or in concert significantly affected measurement and reporting of accounting items in annual reports depending on the choice of treatment adopted by a company. The measurement practices adopted or possible treatments used for the above variables in the financial statements were based on the actual practices adopted by the companies (listed in Appendix-2) and such practices depicted in the annual reports of respective companies.

While presenting the changes in harmonization level in different periods, they are presented in absolute values raging between '0' and '1' with four decimals or in terms of percentages. The latter method is also advocated by Tay and Parker [1990:*86*].

In order to analyze the stated hypotheses, the data from the annual reports were collated on the basis of six independent variables, which comprised of age, performance, size, operation, sectors, and equity base of the sample companies. The data was collated on Microsoft Excel and SPSS package to arrive at meaningful analyses and conclusions. The statistical tools used in the study were H-Index, chi-square, mean value and standard deviation.

OPERATIONAL DEFINITIONS

In carrying out the present study, the following operational definitions of (i) Age; (ii) Performance; (iii) Size; (iv) Operation; (v) Sectors; and (vii) Equity Base were adopted.

(i) **Age:** Based on age, the respondent companies were classified into new companies and old companies. New companies were defined as those companies which were established not earlier than twenty-five years by 2006 and old companies were defined as those which were established before twenty-five years back.

(ii) **Performance:** Based on performance, the respondent companies were classified into low profit companies and high profit companies. Based on the median profit of Rs.19.5 crore for the year 2006 of these 104 sample companies, low profit companies were defined as those having a profit of less than Rs. 19.5 crore and high profit companies were defined as those having the profit of Rs. 19.5 crore and above.

(iii) **Size:** From the viewpoint of size, respondent companies were classified into small companies and large companies. Based on median book value (also called net worth) of Rs.104.37 crore, small companies were defined as those which had book value of less than 104.37 crore and large companies as those which had the book value of Rs.104.37 crore and above.

(iv) **Operation:** From the viewpoint of operation, companies were classified into multinational and domestic companies. Multinational companies were defined as those companies which carried out operations in number of other countries including India and such companies have been incorporated in India also. Domestic companies were defined as those companies which were formed by Indian nationals and carried out their operations in India and elsewhere.

(v) **Sectors:** From the viewpoint of sectors, companies were classified based on the classification made by the Government of India Ministry of Statistics and Programme Implementation into three groups (i) Basic and capital goods industries; (ii) Intermediate goods industries; and (iii) Consumer durable goods industries.

(vi) **Equity Base:** Based on equity base, companies were classified into low equity base companies and high equity base companies. Based on median equity of Rs.14.97 crore of sample companies, low equity base companies were defined as those which had less than paid up equity capital of less than Rs.14.97 crore and high equity base companies were defined as those which had the equity capital base of Rs. 14.97 crore and above.

LIMITATIONS OF THE STUDY

The research was undertaken with the following limitations and hence the implications of these findings should be taken very cautiously:

(i) All industries were not represented in this study. It focused only on those industries, which had significant interest in the manufacturing activities. Therefore, the results may not be generalized to the accounting practices of all types of Indian industries

(ii) The annual reports of Indian companies were randomly selected and the sample size was also small. Hence the selection might not represent the universe.

(iii) In this study, only nine accounting measurement practices were studied. For more refined result, it is suggested to include more number of both measurement and disclosure practices.

(iv) In this research, only measurement practices were considered and disclosure practices were not considered.

(v) Because of insufficient explanation, it was not possible to determine the way in which a company chose to account for an item. There was difficulty to determine whether a company did not account for a particular item because it was not applicable or because the company opted not to take the item into account.

CHAPTERIZATION

The following is the chapterization scheme of the study.

Chapter No.	Title of the Chapter
I	Introduction
II	Financial Reporting Standards: An Overview
III	Harmonization: Proponents and Measurements
IV	Review of Literature
V	Analysis and Interpretation of Data
VI	Summary of Conclusions and Suggestions