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GAZDASÁGI HATÁSAI**

**THE ROLE AND EFFECTS OF INTERNATIONAL ACCOUNTING
STANDARDIZATION**

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1. INTRODUCTION

The purpose of this study was to measure the differences between national rules and the international standards, evaluating and analyzing their effects on the business environment. The financial data are taken from accounts published on the Budapest Stock Exchange and in the Hungarian Business Information database. The results show that those businesses which have adopted international standards achieved higher and statistically significant positive coefficients than those who follow local accounting rules. We found that larger firms (those with more leverage, higher market capitalization and substantial foreign sales) were more likely to have adopted international accounting standards.

In this review the goal is to describe and summarize how the international accounting information system can help business decisions and influence the business environment in a global scale. The unified, standardized accounting information system will lead to new types of analysis and data, furthermore with the possible integration of new indicators from the business practice of certain countries.

Since in case such multinational companies like Daimler Chrysler owning more than 900 subsidiaries, operating on 5 continents in more than 60 countries, the published financial results according to international standards is 1.5 times of the one according to German accounting standards. If earning after taxation (EAT) – deducted actual tax burdens - according to US GAAP is taken as 100 percent, due to differences between national accounting standards, EAT would be 25% more in UK, 3% less in France, 23% less in Germany and 34% less in Japan (Barth et al., 2007).

With the increasing globalization of the marketplace, international investors need access to financial information based on harmonized accounting standards and procedures. Investors constantly face economic choices that require a comparison of financial information. Without harmonization in the underlying methodology of financial reports, real economic differences cannot be separated from alternative accounting standards and procedures. Harmonization is used as a reconciliation of different points of view, which is more practical than uniformity, which may impose one country's accounting point of view on all others. Organizations, private or public, need information to coordinate its various investments in different sectors of the economy. With the growth of international business transactions by private and public entities, the need to coordinate different investment decisions has increased.

This paper traces the benefits of international accounting standards and their contribution to harmonization in business practice. With increasing globalization of the marketplace, international investors need access to financial information based on harmonized accounting methods and procedures. It is expected that the unified, standardized accounting information system will lead to new types of analysis and data, furthermore with the possible integration of new indicators from the business management practice of certain countries. The author analyzed and valued the effects of international standards on the business economic environments. There was shown that uniform accounting standards will increase market liquidity, decrease transaction costs for investors, lower cost of capital, and facilitate international capital formation and flow. Measuring in details their pros and cons effects on the division of labour, financial innovation, company cost of capital it could be the author's recommendation for the businesses inside and outside of one country's border.

2. DESCRIPTION OF NOWADAYS' BUSINESS ENVIRONMENT

In today's business environment, companies need to take every advantage they can to remain competitive. Global competition, rapid innovation, entrepreneurial competitors, and increasingly demanding customers have altered the nature of competition in the marketplace. This new competitive environment requires companies' ability to create value for their customers and to differentiate themselves from their competitors through the formulation of a clear business strategy. Business strategy must be supported by appropriate organizational factors such as effective manufacturing process, organizational design and unified business accounting information systems also.

Modern business environments are increasingly competitive and dynamic. International competition through e-commerce and demand-based supply chain management dominate business. It is important for companies to develop coherent and consistent business strategies and to utilize business accounting tools to support strategic planning, decision-making and control. To integrate business strategies with various business accounting tools, first companies need to identify which business they are in. It is essential to identify products and services, customer types, geographical markets, and delivery channels. It is useful to match the strategic business unit (SBU) with the related business unit strategy. An SBU is a company department or sub-section which has a distinct external market for goods or services that differ from another SBU. A business unit strategy is about how to compete successfully in particular markets. It is important to focus on a certain segment, such as environmentally friendly cars in the automobile industry or internet and phone banking in the retail banking industry.

To be successful in this cut-throat competition business world is very tough particularly if you are not too familiar with the diverse strategies which are needed to make a business successful. If you cannot make a success story out of your business, there is no use of operating a business. You must have to undertake some strategies to run your business successful. These strategies are accounting, bookkeeping, marketing, promotion, production and manufacturing. Now what a business owner needs to do is prioritize work - what need to be done on priority basis. And this will vary greatly from business to business. Accounting help is something that any business requires to embark on, in particular if you are operating a large scale business. If you are running a small or mid-size business than you can easily handle the accounting work without obtaining professional assistance.

Generally, in a very large company, each division has a top accountant called the controller, and much of the management accounting that is done in these divisions comes under the leadership of the controller. On the other hand, the controller usually reports to the vice president of finance for the division who, in turn, reports to the division's president and/or overall chief financial officer (CFO). All of these individuals are responsible for the flow of good accounting information that supports the planning, control, and evaluation work that takes place within the organization.

Business management requires that resource consumption be measured, rated, assigned, and communicated between appropriate parties. *Managers of businesses use accounting information to set goals for their organizations, to evaluate their progress toward those goals, and to take corrective action if necessary.* Decisions based on accounting information may include which building and equipment to purchase, how much merchandise inventory to keep on hand, and how much cash to borrow, etc. Modern accounting renders its services to a wide variety of users: investors, government agencies, the public, and management of enterprises, to mention but a few. Many accountants work in business firms as managerial accountants, internal auditors, income tax specialists, systems experts, controllers, management consultants, financial vice presidents, and chief executives.

Accounting will help a business or organization to keep a proper record of all the financial aspect. Therefore, every individual or business requires keeping a track of all the financial dealings that they do on a daily basis. Because this is the only thing that will measure how well or how bad their business is doing. Many times it happens that the person managing the accounting and other financial aspect of the business does not make a habit to keep track on all the financial records on daily or weekly basis. Thus, business owner may not get the proper picture for their business – how good or how bad business is doing. This is true especially with small and mid-size businesses. It is very vital to have all the things well organized and documented, especially if you are of those who forget things.

Accounting is something that no one can avoid and therefore one must ensure that they get the best professionals to do the work for them. There are quite a lot of companies that offer accounting help with other bookkeeping and accounting services to individuals and business owners who are looking out for these services. If you have a glance at global accounting outsourcing statistics, you will notice that an increasingly large number of businesses are undertaking this strategy for their business success. Hence, if your name is yet to be in those statistics, it is a good time for you to seek accounting help for your

business. There are number of advantages of outsourcing your accounting, and this is the cause why there is a vast flow in the number of business owners and entrepreneurs opening up to the idea of outsourcing their work.

To have strategic value, management accounting must help to accomplish the three strategic objectives of *quality*, *cost*, and *time* by providing information that:

1. Links the daily actions of managers to the strategic objectives of an organization.
2. Enables managers to effectively involve the entire extended enterprise of customers, suppliers, dealers, and recyclers in achieving the strategic objectives.
3. Takes a long-term view of organizational strategies and actions.

The purpose of management accounting in the organization is to support competitive decision making by collecting, processing, and communicating information that helps management plan, control, and evaluate business processes and company strategy. The interesting thing about management accounting is that it is rare to find an individual within a company with the title of “management accountant.” Often many individuals function as accountants within the organization, but these individuals typically operate as financial accountants, costs accountants, tax accountants, or internal auditors. However, the ability to develop and use good management accounting (which covers a lot more ground than the product costing done by cost accountants) is actually an important ability for many individuals, including finance professionals, operational and marketing managers, top-level executives, and information technologists.

The fundamental purpose of management accounting is to help an organization achieve its strategic objectives. Meeting these objectives satisfies the needs of its customers and other stakeholders. Typical stakeholders include shareholders, creditors, suppliers, employees, and labour unions. Corporations need to implement adequate internal controls, guidelines and policies to stay competitive and increase profit levels. Senior leaders rely on management accounting and strategy tools to review corporate processes and make short-term and long-term decisions.

The role of the management accountant is to perform a series of tasks to ensure their company's financial security, handling essentially all financial matters and thus helping to drive the business's overall management and strategy. A management accountant's responsibilities can range widely. Depending on the company, your level of experience, the time of year and the type of industry, you could find yourself doing anything from

budgeting, handling taxes and managing assets to helping determine compensation and benefits packages and aiding in strategic planning.

International management accounting is the practical application of management techniques to control and report on the financial resources of the business entities. This involves the analysis, planning, implementation, and control of programs designed to provide financial reporting for managerial decision making. It is covering the maintenance of the accounts, developing financial statements, cash flow and financial performance analysis. Since accounting applications do not have uniform security and reliability requirements, it is not possible to devise a single accounting protocol and set of security services that will meet all needs. Thus the goal of management accounting is to provide a set of tools that can be used to meet the requirements of each application. International management accounting requires that resource consumption be measured, rated, assigned, and communicated between appropriate parties. Especially the multinational companies spend enormous money for preparing and auditing their accounting reports according to the different national regulations. For these multinational companies the aspects of maximizing the profit is significantly more important than the consideration of national interest or the geographical position. Because of this there is a demand for creating such accounting systems which are evaluating the economic results equally.

According to the business practice it is obvious that the usage of international accounting principles leads to a reduction of the information asymmetry between the owners and the managers. By this information asymmetry the costs of equities are growing and the economic and financial forecasts are less accurate. This requires the development and a review of the national accounting rules, the separate validation of tax and accounting regulation, repeal of the subordinate role of accounting, issuing international standards with practical and theoretical accounting experts.

Historically, standardization of the international accounting principles has tended to follow the integration of the markets served by the accounts. For example, the move to unified national accounting in the US in the early 20th century followed the integration of the national economy. Similarly the present impetus for global accounting standards follows the accelerating integration of the world economy. Without the common accounting standards the cross-border portfolio and direct investment may be distorted, the cross-border monitoring of management by shareholders obstructed, and the cross-border

contracting inhibited and the cost of these activities may be needlessly inflated by complex translation (Meeks & Swamm, 2009).

To sum up, according to studies regarding the adoption of international financial accounting standards (IFRS), the companies that adopted IFRS needed to spend less time with earnings management and recognized loss immediately. These companies also experienced an improvement in their accounting quality. The adoption of IFRS also raised market liquidity and the value of the company. But we also have to add that these positive effects can be experienced mostly in those countries where the institutional background is appropriate. To be sure, arriving at accounting standards that promote a more faithful representation of economic reality is extremely challenging. Indeed, as some have argued, the economics of a transaction are often in the eye of the beholder (Zeff, 2006).

Accounting regulation in The European Union was introduced in 2005 obligated economic entities listed and traded on stock markets to apply IFRS on consolidated financial statements exerted a decisive influence on the accounting globalization. Since in case such multinational companies like Daimler Chrysler owning more than 900 subsidiaries, operating on 5 continents in more than 60 counties, the published financial results according to international standards is 1.5 times of the one according to German accounting standards. If earning after taxation (EAT) – deducted actual tax burdens - according to US GAAP is taken as 100 percent, due to differences between national accounting standards, EAT would be 25% more in UK, 3% less in France, 23% less in Germany and 34% less in Japan (Barth et al., 2007).

An analysis (Ormrod & Taylor, 2006) of non-economic entities among the 100 largest companies listed on London stock market was performed and published by the University of Liverpool, UK. This research created for international accounting gave unique opportunities to retrieve comparable data. Financial performance of a given period was examined and introduced according to international as well as British accounting standards indicating that in case of 50 out of 100 economic entities, conversion into IFRS would increase EAT by 39%. Analysis was performed to find out which standards are reliable for that and turned out that only several of them caused differences. In most examined standards results differed in a small proportion. Results were weighted on the bases of economic entities' size. Significant difference (24%) was indicated by the review of goodwill. Financial investments accounted for the second important factor, resulting 13% changing. Applying to international accounting standards could decrease shareholders fund by 23%. Converting to IFRS would indicate the most significant decrease in

allowances (including pension), namely 26%. Surprisingly most of the standards had minor deviations were indicated by dividend (3%) and finite tax change (1%). Allowances – especially pension – was expected to have significant effects, but it rather reflected the changes of British regulations instead of IFRS. Deviations of financial statement derived from different accounting system could hardly measure in case of such large companies like British Petrol.

The goal of business management is to provide a set of tools that can be used to meet the requirements of each application. Since accounting applications do not have uniform security and reliability requirements, it is not possible to devise a single accounting protocol and set of security services that will meet all needs. Business management requires that resource consumption be measured, rated, assigned, and communicated between appropriate parties.

Managers of businesses use accounting information to set goals for their organizations, to evaluate their progress toward those goals, and to take corrective action if necessary. Managers of businesses use accounting information to set goals for their organizations, to evaluate their progress toward those goals, and to take corrective action if necessary. Decisions based on international accounting information system may include which building and equipment to purchase, how much merchandise inventory to keep on hand, and how much cash to borrow, etc. Modern accounting renders its services to a wide variety of users: investors, government agencies, the public, and management of enterprises, to mention but a few. Many accountants work in business firms as managerial accountants, internal auditors, income tax specialists, systems experts, controllers, management consultants, financial vice presidents, and chief executives.

Accounting is, therefore, a service to management, a special-purpose tool which must be used but not misused. Like any special-purpose tool, if it is neglected or not used it will surely go rusty and fail to provide the good service for which it was designed. However, all tools have their limitations and it is well to point out at this early stage some fundamental limitations inherent in any system of accounting.

The importance of accounting within a business should not be underestimated. It provides the basic information by which managers and owners can judge whether the business is meeting its objectives. Its importance is shown by the high salaries that accountants can command and by the prevalence of accountants on the boards of directors of major public companies.

Accounting is also different from other business functions in that it is not only a function but also an industry. The accounting industry sells accounting and other advisory services to other businesses and is itself a major employer of graduate labour. Accounting can be and is used within business to evaluate and shape alternative strategies such as making a component of buying it in from a supplier, thus shaping business plans and activities. At the same time it is itself a function of the type of activity that a business engages in and of the strategies a business adopts.

Decisions based on international accounting information system may include which building and equipment to purchase, how much merchandise inventory to keep on hand, and how much cash to borrow, etc. Modern accounting renders its services to a wide variety of users: investors, government agencies, the public, and management of enterprises, to mention but a few. Many accountants work in business firms as managerial accountants, internal auditors, income tax specialists, systems experts, controllers, management consultants, financial vice presidents, and chief executives.

International Financial Reporting Standards (IFRS) are accounting principles, methods ('standards') issued by the International Accounting Standards Board (IASB), an independent organisation based in London. They purport to be a set of standards that ideally would apply equally to financial reporting by public companies worldwide. Between 1973 and 2000, international standards were issued by IASB's predecessor organisation, the International Accounting Committee (IASC), a body established in 1973 by the professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, Netherlands, United Kingdom and Ireland, and the United States. During that period, the IASC's principles were described as 'International Accounting Standards' (IAS). Since April 2001, this rule-making function has been taken over by a newly-reconstituted IASB. From this time on the IASB describes its rules under the new label 'IFRS', though it continue to recognise (accept as legitimate) the prior rules (IAS) issued by the old standard-setter (IASC). The IASB is better-funded, better-staffed and more independent than its predecessor, the IASC. Nevertheless, there has been substantial continuity across time in its viewpoint and in its accounting standards.

Nowadays, especially during the current global financial crisis, companies in Hungary are striving desperately to remain competitive and achieve sustainable levels of economic development. The highly competitive environment requires companies to create a clear business strategy, and accounting has to be part of this strategy since it helps

individual enterprises to achieve their strategic objectives. International accounting standards are new global methods for business information systems and they are able to harmonize financial regimes both world-wide and in Hungary also. The increased globalization of markets, the complexity of commercial trading and the concentration of business in global competition have led to a still greater need for international harmonization.

Modern business environments are increasingly competitive and dynamic. International competition through e-commerce and demand-based supply chain management dominate business. It is important for companies to develop coherent and consistent business strategies and to utilize management accounting tools to support strategic planning, decision-making and control. To integrate business strategies with various management accounting tools, first companies need to identify which business they are in. It is essential to identify products and services, customer types, geographical markets, and delivery channels. It is useful to match the strategic business unit (SBU) with the related business unit strategy. An SBU is a company department or sub-section which has a distinct external market for goods or services that differ from another SBU. A business unit strategy is about how to compete successfully in particular markets. It is important to focus on a certain segment, such as environmentally friendly cars in the automobile industry or internet and phone banking in the retail banking industry.

The financial crisis is also encouraging more critical examinations of the managerial innovations that have emerged from the audit industry, not least its pursuit of the bureaucratisation of risk in the name of risk management. Coming through a crisis where risks have been real and perceived, increasingly it is coming to be seen that risk management mechanisms do relatively little to facilitate the real management of risk. Adding as they do to costs – and the income of the consultancies involved, by isolating rather than integrating the management of risk, the bureaucratic mechanisms still promoted by the audit firms and their associates provide yet further evidence of the relatively limited understanding that the audit industry has of real time management in action.

Trying to understand the crisis and reflect on its implications also illustrates the dangers of the drift away from the world of accounting practice that has been a characteristic of so much accounting research for the last few decades. Indeed at times it is possible to think that for some there has been a drift away from accounting itself: at the very least there has been a pronounced move towards studying accounting at a distance. As yet this has not been as severe in its implications as for those of our colleagues in finance

research where increasing numbers have a very limited appreciation of the complexities of practice and its institutional context. There nevertheless has been a move away from analyzing just such complexities and institutional contexts in the accounting area, often in the name of theoretical elegance and methodological rigour. Interestingly this is true for both statistically based capital market studies and a great deal of more critical theorizing. Of course theoretical and methodological issues are of real importance, not least in helping to avoid methodological capture by practice norms, frameworks and ways of looking at the world. But as numerous other social science disciplines illustrate, there are ways of balancing interests in the need for sound and reliable research with genuine interests in the complexities of practice. It really is important to understand how accounting has become implicated with the creation of new financial practices, with objectifying and simplifying the increasingly complex financial transactions that have emerged from an ever expanding investment in financial engineering. Equally significant is the need for a more informed understanding of the changes that have occurred in the influence structures in the world of accounting politics both national and international, of the changing role that accounting plays in the informational environment of organizations and with how accounting changes in relation with shifts in the underlying nature of the socio-economic system in which business operates.

Standardization is the process of developing and agreeing upon technical standards. The standard is a document that establishes uniform engineering or technical specifications, criteria, methods, processes, or practices. Some standards are mandatory while others are voluntary. Voluntary standards are available if one chooses to use them. Some are de facto standards meaning a norm or requirement which has an informal but dominant status. Some standards are de jure meaning formal legal requirements. Formal standards organizations such as the International Organization for Standardization or the American National Standards Institute are independent of the manufacturers of the goods for which they publish standards.

In social sciences, including economics, idea of standardization is close to the solution for a coordination problem, a situation in which all parties can realize mutual gains, but only by making mutually consistent decisions. Standardization implies the elimination of alternatives in accounting for economic transactions and other events. Harmonization refers to reduction of alternatives while retaining a high degree of flexibility in accounting practices. Harmonization allows different countries to have different standards as long as the standards do not conflict. For example, within the

European Union harmonization program, if appropriate disclosures were made, companies were permitted to use different measurement methods: for valuing assets, German companies could use historical cost, while Dutch businesses can use replacement costs without violating the harmonization requirements.

3. PREVIOUS RELATED INTERNATIONAL LITERATURE REVIEW

International accounting literature provides evidence that accounting quality has economic consequences, such as costs of capital (Leuz and Verrecchia, 2000), efficiency of capital allocation (Bushman and Piotroski, 2006) and international capital mobility (Guenther and Young, 2002).

The International Accounting Standards Board (IASB) has planned to develop a uniform and understandable global accounting convergence (Easton, 2006), and the IASB's plan has resulted in more than 100 countries world-wide now requiring, permitting or adopting International Financial Reporting Standards (IFRS) (Epstein, 2009). This growing acceptance of IFRS has also influenced emerging economies (Ball, Robin and Wu, 2003). Beke (2010a:49) asserted that "the purpose of the use of international accounting information systems is that similar transactions are treated the same by companies around the world, resulting in globally comparable financial statements". These findings have led many authors to conclude that global comparability will be driven by factors other than the accounting standards. In particular, most authors point to either regulatory oversight or capital market pressures (Burgstahler, Hail and Leuz, 2006).

Researchers have suggested that the best approach to assessing the applicability of IFRS is to evaluate the convergence process in emerging markets (Jones and Higgins, 2006, Cordazzo, 2008). However, the process of adoption has been the subject of limited research, since researchers themselves have suggested that it would be better to use national case studies to analyse the adoption of IFRS in individual nations. Examples of this are Callao-Jarne-Lainez (2007) in Spain, Cormier-Demaria-Lapointe-Teller (2009) in France, Lantto and Sahlström (2009) in Finland, Iatridis and Rouvolis (2010) in Greece, Peng and Smith (2010) in China and Beke (2010b) in Hungary also.

The research undertaken in the form of national case studies will develop guide-lines on best practice in the implementation of IFRS in order to assist developing countries and countries with economies in transition to succeed in their efforts to harmonise their national accounting rules and practice with international requirements

Earlier literature shows that the level of the capital market orientation of the financial environment also follows the differences in accounting systems internationally. Examples of this are found when the Common Law accounting systems of the USA and the UK are compared with Code Law-based systems of many Continental European countries (see, for example, La Porta, 1998).

Earlier studies show that, in Code Law countries (e.g., in Europe) the capital provided by banks tends to be more important than in Common Law countries e.g., the USA and Canada) where firms are mainly financed by a large number of private investors (Barth et al., 2004). Therefore, information asymmetry between capital providers and the company is likely to be resolved in Code Law countries by providing accounting information to the capital providers by means of high-quality, public financial reporting (e.g. Beke, 2011a).

Previous studies also show that the adoption of IFRS improves the accounting quality of publicly traded companies in Europe (Daske and Gebhardt, 2006). Overall, the adoption of IFRS seems to benefit investors, especially in countries which resemble Code Law clusters and where the information needs of investors were not the primary interest of standards setters.

Additionally, many papers examine the properties of accounting information across different accounting regimes. Overall, these studies indicate that similar accounting methods are applied very differently around the world. However, Beke (2011b) remarked that “the unified accounting information system will probably lead to new types of analysis and data – with the possible additional integration of new indicators from the practice of certain countries”.

The purpose of the use of international accounting methods is that a single set of standards ensures similar transactions are treated the same by companies around the world, resulting in globally comparable financial statements. However, looking at accounting standards as consistently by firms, we see that they are changeable since they depend on the varying economic, political, and cultural conditions in one state. Accounting standard-setters and regulators around the globe are planning to harmonize accounting standards with the goal of creating one set of high-quality rules to be applied world-wide (Whittington, 2008).

Epstein (2009) compared characteristics of accounting amounts for companies that adopted IFRS (International Financial Reporting Standards) to a matched sample of companies that did not, and found that the former evidenced less earnings management, more timely loss recognition, and more value relevance of accounting amount than did the latter. This study found that IFRS adopters had a higher frequency of large negative net income and generally exhibited higher accounting quality in the post-adoption period than they did in the pre-adoption period. The results suggested an improvement in accounting quality associated with using IFRS.

Botsari and Meeks (2008) found that first time mandatory adopters experience statistically significant increases in market liquidity and value after IFRS reporting becomes mandatory. The effects were found to range in magnitude from 3 to 6% for market liquidity and from 2 to 4% for company by market capitalization to the value of its assets by their replacement value.

Daske et al. (2007) also found that the capital market benefits were present only in countries with strict enforcement and in countries where the institutional environment provides strong incentives for transparent filings. In the order of the IFRS adoption countries, market liquidity and value remained largely unchanged in the year of the mandate. In addition, the effects of mandatory adoption were stronger in countries that had larger differences between national GAAP (General Accepted Accounting Principles) and IFRS, or without a pre-existing convergence strategy toward IFRS reporting.

The increased transparency promised by IFRS also could cause a similar increase in the efficiency of contracting between firms and lenders. In particular, timelier loss recognition in the financial statements triggers debt covenants violations more quickly after firms experience economic losses that decrease the value of outstanding debt (Ball and Shivakumar, 2005; Ball and Lakshmann, 2005).

Accounting theory argues that financial reporting reduces information asymmetry by disclosing relevant and timely information for example Frankel and Li (2004). Because there is considerable variation in accounting quality and economic efficiency across countries, international accounting systems provide an interesting setting to examine the economic consequences of financial reporting. The European Union's (EU) movement to IFRS may provide new insights as firms from different legal and accounting systems adopt a single accounting standard at the same time. Improvement in the information environment following change to IFRS is contingent on at least two factors, however. First, improvement is based upon the premise that change to IFRS constitutes change to a GAAP that induces higher quality financial reporting. For example, Ball et al. (2006a) found that the accounting system is a complementary component of the country's overall institutional system and it is also determined by firms' incentives for financial reporting. Second, the accounting system is a complementary component of the country's overall institutional system (Ball et al., 2006b) and is also determined by firms' incentives for financial reporting. La Porta et al. (1998) provide the first investigation of the legal system's effect on a country's financial system. The results suggested that common law countries have better accounting systems and better protection of investors than code law countries.

Other factors associated with financial reporting quality include the tax system (Daske and Gebhardt, 2006), ownership structure (Jermakovicz et al., 2007, Burgstahler et al., 2006), the political system (Li and Meeks, 2006), capital's structure and capital market development (Ali et al., 2000). Therefore, controlling for these institutional and firm-level factors becomes an important task in the empirical research design. As a result of the interdependence between accounting standards and the country's institutional setting and firms' incentives, the economic consequences of changing accounting systems may vary across countries. Few papers have examined how these factors affect the economic consequences of changing accounting standards. For example, Pincus et al. (2007) found that accrual anomaly is more prevalent in common law countries. Maskus et al. (2005) found that accounting quality is associated with tax reporting incentives. Exploration of the interaction between these factors and the accounting information system can provide insights into differences in the economic consequences of changing accounting principles across countries.

Prior researches, for example, Meeks and Meeks (2002) have raised substantial doubt regarding whether a global accounting standard would result in comparable accounting around the world. But differences in accounting practices across countries can result in similar economic transactions being recorded differently. This lack comparability complicates cross-border financial analysis and investment. In the researches of Iatridis and Rouvolis (2010) are some evidence of earning management (e.g. reducing of transition costs and information asymmetry, benefits of investors in investment strategy). They showed how firms that operate in a non-common-law countries (e.g. Greece), which is stakeholder-based respond to international accounting standards adoption as compared to shareholder-based systems (e.g. United Kingdom).

No matter how similar the accounting systems in different countries are, there will be slight or even bigger differences in the way they are applied by companies due to the differences in the economic, political and cultural environment. Chatterjee (2006) presented in his study how cultural differences can affect accounting practices is that in the countries which are characterized with small power distance and weak uncertainty avoidance accounting measures are more likely to be used as an indicator of a manager's performance than as a measure of the effectiveness of policies and procedures prescribed for them. Various researches draw the conclusion that countries having different cultures have also different accounting rules and practices.

4. CLASSIFICATION OF ACCOUNTING SYSTEMS

In this paper “accounting system” would be used as the financial reporting practices used by a company for an annual report. The systems could be classified into groups by similarities and differences. If all or most of the enterprises in a country are employed by very similar accounting practices, this might suggest that countries can be classified on the basis of accounting practices.

The classification of accounting systems should help to describe and compare international accounting systems in a way that will promote improved understanding of the complex realities of accounting practice. This classification should contribute to an improved understanding of:

- the extent to which national accounting systems are similar to or different from each other,
- the pattern of development of individual national systems with respect to each other and their potential for change,
- the reasons why some national systems have a dominant influence while others do not.

Classification should also help policymakers assess the prospects and problems of international harmonization. Developing countries seeking to choose an appropriate accounting system will also be better informed about the relevance for them of the systems used by other countries. The education of accountants and auditors who operate internationally would also be facilitated by an appropriate classification system.

The next hypothetical classification by Doupnik and Perera (2007) based on some explanatory variables for differences in measurement practices.

Classes:

- micro-fair-judgemental and commercially driven,
- macro-uniform government-driven and tax-dominated.

Sub-classes:

- business economics and extreme judgemental (Netherlands),
- business practice, professional rules and British origin.

Families:

- UK influenced and professional regulated (Australia, New-Zealand, UK, Ireland),
- US influenced and enforcement by SEC (Canada, Israel, USA).
- code-based and international influenced (Italy),

- plan-based (France, Belgium, Spain),
- statue-based (Germany, Japan),
- economically controlled (Sweden).

All attempts were made to isolate those features of a country's financial reporting practices that may constitute long-run fundamental differences between countries. The result was a selection of nine factors:

1. type of users of the published accounts of listed companies,
2. degree to which law or standards prescribe in detail and exclude judgement,
3. importance of tax rules in measurement,
4. conservatism/prudence (e.g. valuation of assets),
5. strictness of application of historical cost (in the historical cost accounts),
6. susceptibility to replacement cost adjustments in main or supplementary accounts,
7. consolidation practices,
8. ability to be generous with provisions (as opposed to reserves) and to smooth income,
9. uniformity between companies in application of rules.

Connections:

- micro-fair-judgemental and commercially driven class covers two sub-classes:
 - business economics and extreme judgemental,
 - business practiced, professional rules and British origin.
- macro-uniform, government-driven and tax-dominated class contents four families:
 - code-based and international influenced,
 - plan-based,
 - statue-based,
 - economically controlled.

The micro-fair-judgemental and commercially drives class is also known as the Anglo-Saxon or Anglo-American model, used to describe to approach of the United Kingdom and United States, where accounting is oriented toward the decision needs of large numbers of investors and creditors. This model is employed by most English-speaking countries and others heavily influenced by UK or US.

The macro-uniform, government-driven and tax-dominated class originated in the code law countries of continental Europe. It is also known as the Continental European model. It is used by most of Europe, Japan, and other code law countries. Companies in

this group usually are tied quite closely to banks that serve as the primary suppliers of financing.

The inflation-adjusted model is found primarily in South America. This model distinguishes itself, however, through the extensive use of adjustments for inflation (Argentina, Brazil, Chile and Mexico).

The UK-influenced countries are former British colonialism on accounting development: Hong Kong, Malaysia, Nigeria, Philippines, South Africa, Singapore, Taiwan, Sri Lanka, Zambia, Botswana, Namibia, and Zimbabwe.

The macro-uniform countries and companies in the macro countries are more heavily influenced by taxation than are companies in the micro countries.

These factors were designed to operate for developed countries which share certain economic features. If one wished to include developing countries, it would be necessary to include other discriminating factors, such as the degree of development of economy or nature of economic systems.

Nobes (2006) showed the classification of some financial reporting systems. In this system 'US GAAP' means the well-defined set of practices required by US regulators to be used by certain US companies. Users of this system are SEC-registered US companies, and certain large Japanese companies for their group accounts. US GAAP bears a family resemblance to UK and IFRS rules, and is in a class of systems suited to strong equity markets.

Strong equity class covers UK, Irish, Dutch individual and US SEC-registered companies.

Weak equity class contains Belgian, French, German, Italian and Japanese enterprises.

Radebaugh and Gray (2002) presented the cultural classification of international accounting systems:

- anglo-american culture area (United States, United Kingdom and British colonies),
- nordic countries (The Netherlands, Sweden, Finland, Denmark),
- germanic accounting (Germany, Austria, Israel, Switzerland, and former European colonies in Africa),
- latin group (France, Italy, Brazil, Argentina, Belgium, Portugal, Spain, Chile, Colombia, Mexico, Peru, and Uruguay),
- asian accounting (China, Japan, India, Pakistan, Hong Kong, Singapore, Malaysia, and Philippines).

5. INTERNATIONAL ACCOUNTING STANDARDS (IAS)

International Accounting Standards (IAS) are accounting principles, rules, methods ('standards') issued by the International Accounting Standards Board (IASB), an independent organisation based in London, U.K. They purport to be a set of standards that ideally would apply equally to financial reporting by public companies worldwide. Between 1973 and 2000, international standards were issued by IASB's predecessor organisation, the International Accounting Committee (IASC), a body established in 1973 by the professional accountancy bodies in Australia, Canada, France, Germany, Japan, Mexico, Netherlands, United Kingdom and Ireland, and the United States. During that period, the IASC's principles were described as 'International Accounting Standards' (IAS). Since April 2001, this rule-making function has been taken over by a newly-reconstituted IASB. From this time on the IASB describes its rules under the new label 'IFRS', though it continue to recognise (accept as legitimate) the prior rules (IAS) issued by the old standard-setter (IASC). The IASB is better-funded, better-staffed and more independent than its predecessor, the IASC. Nevertheless, there has been substantial continuity across time in its viewpoint and in its accounting standards.

Widespread international adoption of IFRS offers equity investors the next potential advantages by Ball et al. (2006):

- 1) IFRS promise more accurate, comprehensive and timely financial statement information, relative to the national standards they replace for public financial reporting in most of the countries adopting them, Continental Europe included.
- 2) Small investors are less likely than investment professionals to be able to anticipate financial statement information from other sources improving financial reporting quality allows them to compete better with professionals, and hence reduces the risk they are trading with a better-informed professional.
- 3) IFRS eliminate many of the adjustments analysts historically have made in order to make companies' financials more comparable internationally.
- 4) The reducing of the cost of processing financial information most likely increases the efficiency which the stock market incorporates it in prices.
- 5) IFRS offer increased comparability and hence reduced information costs and information risk to investors.

With increasing globalization of the marketplace, international investors need access to financial information based on harmonized accounting standards and procedures.

Investors constantly face economic choices that require a comparison of financial information. Without harmonization in the underlying methodology of financial reports, real economic differences cannot be separated from alternative accounting standards and procedures. Standardization is used as a reconciliation of different points of view, which is more practical than uniformity, which may impose one country's accounting point of view on all others. Organizations, private or public, need information to coordinate its various investments in different sectors of the economy. With the growth of international business transactions by private and public entities, the need to coordinate different investment decisions has increased. A suitable accounting information system can help multinational enterprises accomplish their managerial functions on a global basis. Further, standardization the manner in which reports are prepared can greatly enhance the value of accounting systems to their users and increase transparency to investors and regulators.

In countries whose culture is characterized as small power distance and weak uncertainty avoidance, one would expect a greater tendency to use accounting measures as an indicator of the results of the manager's decisions. Thus, the profit of a profit centre is more likely to be used as a measure of manager performance than to indicate the effectiveness of policies and procedures prescribed for the manager. Likewise, cost is more likely to serve as an indicator for the results of decisions made by a cost centre manager.

For example, in the US and Taiwan found that managers in many Taiwanese firms did not have the full range of general management skills because the boss virtually all of the decisions. Taiwan's strong uncertainty-avoidance and long-term orientation are consistent with this tendency toward centralization.

Germany's strong uncertainty-avoidance culture also suggests a tendency toward centralization. Evidence of such a tendency is provided by an automobile industry expert. „Of the top 100 managers - at Volkswagen -, 50 are not used to making their own decisions or thinking on their own.” (Lere, 2009: 5).

There is a significant body of evidence that identifiable differences in the dominant culture of countries do exist and that they are associated with differences in the typical accounting practices of countries.

There are divergent views on how comparability should be achieved. Some believe that comparability is best achieved by limiting the application of judgment and selection amongst possible choices. Others believe that comparability may be achieved through disclosure of the judgments that were made and how they impact the financial results. The more comparability is mandated, the more rules will be required to enforce it. Striving to

obtain complete comparability, under detailed rules-based regimes, often defeats the purpose because the real comparability is lost through the many bright lines and exceptions created by the rules themselves.

Business management requires that resource consumption be measured, rated, assigned, and communicated between appropriate parties. Managers of businesses use accounting information to set goals for their organizations, to evaluate their progress toward those goals, and to take corrective action if necessary. Decisions based on accounting information may include which building and equipment to purchase, how much merchandise inventory to keep on hand, and how much cash to borrow, etc. Modern accounting renders its services to a wide variety of users: investors, government agencies, the public, and management of enterprises, to mention but a few. Many accountants work in business firms as managerial accountants, internal auditors, income tax specialists, systems experts, controllers, management consultants, financial vice presidents, and chief executives.

Accounting is, therefore, a service to management, a special-purpose tool which must be used but not misused. Like any special-purpose tool, if it is neglected or not used it will surely go rusty and fail to provide the good service for which it was designed. However, all tools have their limitations and it is well to point out at this early stage some fundamental limitations inherent in any system of accounting.

6. ACCOUNTING STANDARDIZATION

Historically, standardization of the international accounting methods has tended to follow the integration of the markets served by the accounts. For example, the move to unified national accounting in the US in the early 20th century followed the integration of the national economy. Similarly the present impetus for global accounting standards follows the accelerating integration of the world economy. Without the common accounting standards the cross-border portfolio and direct investment may be distorted, the cross-border monitoring of management by shareholders obstructed, and the cross-border contracting inhibited and the cost of these activities may be needlessly inflated by complex translation.

7. THE INFLUENCING FACTORS OF ACCOUNTING STANDARDIZATION

In order to standardize the different kind of financial statements, the International Accounting Standards Board is working on creating accounting principles which can be used in the whole world (Epstein and Mirza, 2007). Although the aim seems to be easy, the execution might be problematic due to the diversity of the current principles. The accounting harmonization establishes a system where the financial statements are standardized therefore they are transparent. However it does not mean that the use of standards would result in an operating consistent accounting system, because there are other factors which have influence on the harmonization process, for instance the national legislation system, the regulations by auditors or by the courts.

The reason for differences in accounting principles between certain nations could be that they vary in the level of economic development, in the legal system, in the taxation system, in the intensity of capital market, so as in the level of inflation, in the typical methods of financing an enterprise, in the shareholder background, finally in the political and cultural traits. These are all determining the regulatory aims and philosophy behind them.

7.1. LEGAL SYSTEM

The legal system of a country mainly influences the accounting principles. There are two main clusters: the ‘civil law system’, based on codification (typical in almost all European

countries except for United Kingdom and in Japan) and the so called ‘common law system’ which is precedent based (typical in the United Kingdom, in the USA). According to certain researches (e.g. Radebaugh and Gray, 2002) the principles of the financial reporting system and the accounting standards (especially regarding the principle of being careful or the discrete evaluation) differ very much from each other.

In the ‘civil law system’ the accounting standards are laid down in laws by the elected deputies. It is not common that companies in these countries (continental Europe and the historical colonies of Belgium, France, Germany, Italy, Portugal and Spain) are registered on stock exchange therefore the publication of financial statements is not a priority.

This system derives from the Roman Law (jus civile) the first description of which was the Codex Justinianus in 529. The codification is done in accounting regulation as well (e.g.: the Hungarian Law of Accounting 100/2000.) however the company law contains the most important rules for the operation of a company such as the publication of the financial statement and its formal requirements. In such countries the accountant professionals motivate the introduction of the international accounting standards. In the ‘common law system’ only the frameworks are determined in the company law and the special regulation is done by the independent committee of accounting. Doing so, the committee focuses on the experience based solutions elaborating in details the accounting rules for profit oriented and non-profit oriented companies.

In the ‘civil law system’ the Accounting Law is rather general, it does not contain special regulations, therefore if the companies face with special problems, they ask for help of auditors or search for other laws e.g. tax laws.

The ‘common law system’ develops much more detailed regulation. For the special cases common general rules are applied (in the USA, Canada, Australia or New Zealand). These countries are very market oriented and the investors trust much more in financial statements than in other states. The publication of this information is crucial. The regulation is clear and much more supporting the information needs of the shareholders, of stakeholders and of analysts. This is the best environment for international accounting standards.

7.2. FINANCING METHODS

The legal forms of companies and the proprietors are different. In Germany, in France, in Italy, the banks give the financial background. However in the United Kingdom or in the USA the companies are financed mainly by shareholders. Generally speaking, in the latter countries the capital markets are quite strong and there is a sounder defence of the shareholders. The company structure could be influenced by the political interests as well.

It is worthwhile to analyze the proprietors and the financing companies in the EU. In Germany it is common that banks own shares of the national companies and they are financing them at the same time. There are several national public limited companies in which Deutsche Bank has a significant portion of shares. The situation is similar in France and in Italy where the banks take part in decision making and in the execution of them too due to their significant amount of shares. In the United Kingdom and in the USA the main proprietors of national companies are rather the institutions than private shareholders. In the continental EU countries there are not many foreign shareholders, so for them it is not crucial to regulate the prompt publication of the financial statements there is no need for as much audit and the tax laws overwrite the accounting requirements. On the contrary the private financing system induce need for adequate accounting information, therefore the accounting rules are more separated from the taxation regulations and they are not in a hierarchical context. There is a strong need for more auditors.

7.3. TAXATION SYSTEM

In France and Germany the taxation laws function as accounting rules too. E.g. in Germany the tax account (Steuerbilanz) equals the accounting accounts (Handelsbilanz). Belgium, Italy and Japan apply similar principles and the taxation laws have strong influence on the financial statements. In the USA and in the United Kingdom the accounting regulation totally differs from taxation regulations and they handle it by deferrals, calculating the difference between the tax payable according to accounting regulation and taxation regulation. This also applies to Holland. There are examples also in Hungary for deferrals of tax payable when it is about consolidation.

7.4. INFLATION

The effect of inflation can be measured in connection with the evaluation of assets or when calculating the profit. The historical accounting principle of evaluation can cause problems in periods when there is a high inflation rate. The main problems come when a multinational company wants to make a consolidation in countries where there is a high inflation rate. The effects of inflation can be seen when evaluating the fixed assets or most directly when converting foreign currency. Measuring profitability can be done in the currency of the parent company or of the affiliate company. For instance, if there is an acquisition, the accounting of the goodwill is a crucial issue. According to the US GAAP after goodwill no amortization can be accounted; they calculate it through the net present value of the capability of producing income.

8. PROBLEMS CAUSED BY ACCOUNTING DIVERSITY

8.1. PREPARATION OF CONSOLIDATED FINANCIAL STATEMENTS

The diversity in accounting practice across countries causes problems that can be quite serious for some parties. One problem relates to the preparation of consolidated financial statements by companies with foreign operations. Consider General Motors Corporation, which has subsidiaries in more than 50 countries around the world. Each subsidiary incorporated in the country in which it is located is required to prepare financial statements in accordance with local regulations. These regulations usually require companies to keep books in local currency using local accounting principles. Thus, General Motors de Mexico prepares financial statements in Mexican pesos using Mexican accounting rules and General Motors Japan Ltd. Prepares financial statements in Japanese yen using Japanese standards. To prepare consolidated financial statements into U.S. dollars, the parent company must also convert the financial statements into U.S. dollars and the parent company must also convert the financial statements of its foreign operations into U.S. GAAP. Each foreign operation must either maintain two sets of books prepared in accordance with both local and U.S. GAAP or, as is more common, reconciliations case, considerable effort and cost are involved company personnel must develop an expertise than one country's accounting standards.

8.2. ASSES TO FOREIGN CAPITAL MARKETS

A second problem caused by accounting diversity relates to companies gaining access to foreign capital markets. If a company desires to obtain capital by selling stock or borrowing money in a foreign country, it might be required to present a set of financial statements prepared in accordance with the accounting standards in the country which the capital is being obtained. Consider the case of the Swedish appliance manufacturer AB Electrolux. The equity market in Sweden is so small (there are fewer than 9 million Swedes) and Elektrolux's capital needs are so great that the company has found it necessary to have its common shares listed on stock exchanges in London and on the NASDAQ in the US, in addition to its home exchange in Stockholm. To have stock traded in the US, foreign companies must either prepare financial statements using U.S. accounting standards or provide a reconciliation of local GAAP net income and stock-

holders equity to US GAAP. This can be quite costly. In preparing for a New York Stock Exchange (NYSE) listing in 2008, the German automaker Daimler-Benz estimated it spent \$ 120 million to initially prepare U.S. GAAP financial statements, it expected to spend \$30 to \$40 million each year thereafter.

8.3. COMPARABILITY OF FINANCIAL STATEMENTS

A third problem relates to the lack of comparability of financial statements between companies from different countries. A lack of comparability of financial statements can have an adverse effect on corporations when making foreign acquisition decisions. There was a very good reason why accounting in the communist countries of Eastern Europe and the Soviet Union was so much different from accounting in capitalist countries. Financial statements were not prepared for the benefit of investors and creditors to be used in making investment and lending decisions. Instead, financial statements were prepared to provide the government with information to determine whether the central economic plan was being fulfilled. Financial statements prepared for central planning purposes have limited value in making investment decisions.

8.4. LACK OF HIGH-QUALITY ACCOUNTING INFORMATION

A fourth problem associated with accounting diversity is the lack of high-quality accounting standards in some parts of the world. There is general agreement that the failure of many banks in East Asian financial crisis was due to three factors:

- a highly leveraged corporate sector,
- the private sector's reliance on foreign currency debt, and
- lack of accounting transparency.

International investors and creditors were unable to adequately assess risk because financial statements did not reflect the extent of risk exposure due to the following disclosure deficiencies:

- the actual magnitude of debt was hidden by undisclosed related-party transactions and off-balance-sheet financing,
- high levels of exposure to foreign exchange risk were not evident,
- information on the extent to which investments and loans were made in highly speculative assets was not available,

- contingent liabilities for guaranteeing loans, often foreign currency loans, were not reported, and
- appropriate disclosures regarding loan loss provisions were not made.

9. THE EFFECTS OF ACCOUNTING STANDARDS ON BUSINESS DECISIONS

9.1. THE FINANCIAL STATEMENTS' ROLE IN PERFORMANCE ASSESSMENT

Financial statements, called as accounting statements in Hungary reflects the results of management or the liability of management to enable making such decisions like investing instruments should be maintained or it should be sold, or the assignment of management should be prolonged or it should be replaced. Usually the total amount and availability of cash and cash equivalents are also requested and assessed since it determines the ability to fulfil obligations (transferring for suppliers, interests and paying out dividend for shareholders). Users of financial statements could even better assess the total amount of cash and cash equivalents if the statement focuses on the financial situation, performance of the business. Financial situation of given economic entity is influenced by the possessed economic resources, financial structure of the entity, its liquidity and ability to adopt environmental changes. Preceding data on possessed economic resources and its changes in the past may be useful to create cash and cash equivalents forecasts while preceding data on financial structure could be used for set up loan forecasts and to determine how future revenues will be divide among shareholders. Analyzing accounting information may also be used to determine how successful the business will be in acquiring additional finances. Forecast based on former rate of liquidity and dispensability may indicate whether the entity will be able to fulfil its due obligations.

Data on the performance of business, especially on its profit are required to forecast the future changes of economic resources what the business is likely to possess, thus data on changes of performance is relevant. From financial forecasts, trend-extrapolations the following conclusions may be drown: whether the given business could raise cash-flow on the basis of existing resources or not; how successfully it could use additional financial resources. Business' ability of raising cash and cash equivalents and cash flow may be derived from all these information. Several means of funds could be determined while creating forecasts of financial situation of given business, like financial resources, working capital, liquid or financial instruments. Information on financial situation primarily indicated in balance sheets while information on performance is indicated in profit and loss statements. Some components of financial statements are connected to each other since they are derived from the same transactions or event. Despite the fact that all of the

statements provide different information, presumably none of them serves only a single purpose or contains answers to all requested questions. Profit and loss statement, statement of cash flow together with a balance sheet could provide an overview of economic entity's performance.

In countries whose culture is characterized as small power distance and weak uncertainty avoidance, one would expect a greater tendency to use accounting measures as an indicator of the results of the manager's decisions. Thus, the profit of a profit centres is more likely to be used as a measure of manager performance than to indicate the effectiveness of policies and procedures prescribed for the manager. Likewise, cost is more likely to serve as an indicator for the results of decisions made by a cost centres manager. For example, a field study comparing companies in the US and Taiwan found that managers in many Taiwanese firms did not have the full range of general management skills because the boss virtually all of the decisions. Taiwan's strong uncertainty-avoidance and long-term orientation are consistent with this tendency toward centralization.

Germany's strong uncertainty-avoidance culture also suggests a tendency toward centralization. Evidence of such a tendency is provided by an automobile industry expert. „Of the top 100 managers (at Volkswagen), 50 are not used to making their own decisions or thinking on their own". (Ormrod and Taylor, 2006).

There is a significant body of evidence that identifiable differences in the dominant culture of countries do exist and that they are associated with differences in the typical accounting practices of countries.

Beside the cultural and the economic characteristics, there are also political and legal ones, which have an effect on the way how a country adopts IFRS. In this respect there is a huge difference between the code law and the common law countries as for the latter ones it is much easier to adopt a principle based system than for the earlier ones, who are rather used to precisely composed acts ruling all of the areas one can think of.

The application of international financial reporting standards will allow greater comparison of international financial results. More sources and reports will be available to a greater audience of analysts to follow trends in countries where previously due to different regulations and thus different reports these were less meaningful. The unified financial reporting system will probably lead to new types of analysis and data, furthermore with the possible integration of new indicators from the practice of certain countries.

New indicators also mean a redistribution and transformation of competencies within a management structure. The evaluation of effectiveness related to the managers' decisions could change the skills requirements needed to fill certain positions and also the tasks assigned to them thus leading to a different organizational culture.

With numerous affiliates, subsidiaries and foreign operations in different countries, multinational companies spend a lot of time and have to pay huge amounts of money for completing their consolidated financial reports. Each subsidiary of multinational corporations has to prepare their financial reports according to their country's national regulations and eventually they all have to reconcile their financials to IFRS or the accounting standards their parent company is using.

Concerning the increase in earnings, the strict application of international standards and the presence of incentives for transparent filings led to higher accounting quality, significant increase in market liquidity and capital market benefits, more timely loss recognition and more value relevance of accounting and more frequent large negative net incomes.

10. ROLE OF INTERNATIONAL ACCOUNTING STANDARDS IN THE DIVISION OF LABOUR

Even the work of Adam Smith concerning division of work demonstrate the significant change that leads from economic entities managed by its owner through divided leadership from shareholder till hired management. Hired management of limited partnership may provide further options for maximize risk management and financing such projects that exceed those available for economic entities managed by its owner. In addition monitoring fund assessment and investment may be challenging without hired experts. Informational asymmetry may occur concerning asset valuation namely external shareholders are usually less informed of financial investments than hired managers what also may cause motivational anxiety. As Adam Smith (1776) has written “Management of such partnerships rather handles shareholders’ investments than its own thus the same caution could not be expected that lead to lavishing of funds...”

Now than let us examine the role of international accounting standards in division of labour, but first of all in absence of its adaptation let us consider the study of Gwilliam et al. (2005): In 1980, Lloyd, one of the largest retail chains in the UK created and published its financial statement without taking into consideration the accounting and audit regulations since the latter one was not in force. Defaults of information flow between branch offices and management could be traced back to the lack of modern and uniformed accounting standards. Different sales values and funds were indicated by the branch offices and by the headquarters due to differing accounting principles and method and self-interest.

Concerning decisions on fund assessment and investments Smith (1996) gave the following examples for the misuse of accounting standards: The Coloroll share company operation in the UK, grew to 10 times of original company within 4 years thanks to acquisitions but kept low rate of (fictive) profit by using accounting tricks, “creating reorganizing reserves”. Next year its capital has degraded and bankrupted. The Accounting Standard Board (ASB) has created and published unified principles and accounting methods to avoid such misunderstandings, differences and failures between economic entities participating in the division of labour. Their aim was to eliminate bankruptcy of such large company like the British Coloroll or the American WorldCom. The board consisting of accounting researchers, experts, auditors aimed to create such standards like restrains management from misinforming shareholders concerning the profit

achieved by company or the amount of dividend. In addition Botsari and Meeks (2008) have created such accounting methods that restrain management from altering former performance, results. Similar case has been published recently in Hungary: the First Hungarian Natural Gas and Energy Trading and Service Provider Ltd tried to alternate its profit by self-revision to “achieve” loss. Sodestrom and Sun (1996) - in their study - introduced methods that may prevent company management from misinforming shareholders by motivating them to apply accounting standards especially in the statements of their performance and funds.

Adoption of IFRS may lead to less time being spent trying to be in line with all the strict rules and regulations that come with the national rules-based accounting. Western European and American multinational corporations have been often outsourcing their accounting tasks to lower cost countries. If a globally accepted financial reporting standard was available, it would be even more likely that companies would contract out their accounting tasks to lower cost countries. Currently, the management of companies from developed countries might be concerned that they do not find the necessary accounting expertise in developing countries. With the adaptation of the worldwide accounting standards, companies could centralize accounting training and could easily set up centralized financial support centres. The number of shared (financial and administrative) service centres could increase considerably. This would benefit the multinational corporations and create a significant number of new jobs in developing countries. With globalization under way, accounting professionals could easily reallocate (especially in the European Union where there are no country borders anymore) to other countries as accounting and financial statement would have a common language. The companies in countries like India, Mexico or even Hungary, have more and more duties taken over from the firms of developed countries and from other organizations. The market is developing, because there is a demand and also supply and the unionisation take over simpler and more. Adoption of IFRS may lead to less time being spent trying to be in line with all the strict rules and regulations that come with the national rules-based accounting. Western European and American multinational corporations have been often outsourcing their accounting tasks to lower cost countries. If a globally accepted financial reporting standard was available, it would be even more likely that companies would contract out their accounting tasks to lower cost countries. Currently, the management of companies from developed countries might be concerned that they do not find the necessary accounting expertise in developing countries. With the adoption of the worldwide accounting

standards, companies could centralize accounting training and could easily set up centralized financial support centres. The number of shared (financial and administrative) service centres could increase considerably. This would benefit the multinational corporations and create a significant number of new jobs in developing countries. With globalization under way, accounting professionals could easily reallocate (especially in the European Union where there are no country borders anymore) to other countries as accounting and financial reporting would have a common language.

On the basis of the standard reports the fiscal and the economic situation of the companies becomes more transparent and comparable among the different countries. The unified standards favour especially for the smaller investors' interest because it is the most difficult for them to examine and compare the data of the statements of different countries. The cost of acquiring the information will be much lower. This transparency and comparability boosts the process of international division of labour at a standard world-market too. So it will be much easier for investors to place their investment to the joined countries, and they can harness the comparative advantages of the international division of labour.

Regarding the division of labour, an obvious advantage can be identified in the case of companies with global operations and foreign reporting requirements. Such benefits include the ability to streamline reporting and reduce related costs by developing common reporting systems and consistency statutory reporting. Such companies could develop regional financial centres, relocate finance resources depending on where they may be needed, and centralize training and development efforts.

11. INTERNATIONAL ACCOUNTING STANDARDS AND FINANCIAL INNOVATION

Statement that standardization has a leading role in innovation is proven in numerous studies e.g. Temple (2005). According to data provided in above mentioned study, 50% of the interviewed person conceived that accounting standards promote innovation. The other 50% of them stated that standards restrain innovation. This involves that standards may promote or restrain innovation as well. This could question mark the role of standards in innovation. As mentioned above and argued by Smith, division of labour promote innovation. New markets could be achieved by using standards thus new markets entries and products may give a significant boost to innovation – as argued by Bae et al. (2008).

Using widely accepted standards for innovative products could also result in better sales figures. Without these standards, low-quality products and remaining stocks could not be relocated, thus innovation would lose its economy-boosting effect. In addition new standards expand the scale of innovative products, market entries thus without new standards, innovative products could be hardly obtained. Loan contracts may also provide us with a perfect example for the role of standards in financial innovation. International accounting information has already took a significant part of such contract, but for now adapting these information for performance assessment become more and more complex. Fluctuation of interest rate is highly influenced by innovation (Easley and Hara, 2004). This involves that higher risk advantage could be achieved through lower interest rate and the lack of negotiations before signing contracts. On the other hand lenders are compensated through exercising extra premium in the interest rate. With such a warranty, lower interest rate could be set, thus both lender and debtor could meet beneficial offer. Even so in some case – e.g. mentioned in their study of Fearnley and Sunder (2007) – terms indicated in the contract were defaulted due to false determination of profit, lowered loan risks “accounting tricks” or due to defaulted payment of instalment. Thus uniformed contract and standardized international accounting methods should be introduced.

In many countries the growth of the financial leasing proves that leasing is like a financial innovation that obtained a long-lasting position in the economic life. The success of leasing could be explained by the arising needs of financial capacity in the economy, and not with the temporary favourable environmental conditions. Alongside the clients in the frame of financial innovation there is an increasing demand for services and goods for

handling wealth, and for that, to have a higher benefit in the case of unfavourable financial conditions.

Nowadays, in many countries the accounting systems do not put the interests of the investors at the first place primarily, but the interests of the credit banks and tax aspects. The introduction of the IFRS helps countries to converge their accounting systems to the Anglo-Saxon model, where the report is made on the ground of the aspects of the investors. The standard system could help to spread the financial innovations in a wider environment, because the IFRS is similar to the Anglo-Saxon approach and it is the most efficient where there is a prosperous capital market. It would support the spread of the financial innovations worldwide and the unified attendance in the accounting systems.

12. THE EFFECTS OF INTERNATIONAL ACCOUNTING STANDARDS ON THE TRANSACTION COSTS

Naturally financial markets may not be misleading with accounting tricks for good. Despite the fact that information concerning market prices could not be published by using international accounting standards, it remains essential to assess stock prices. If an economic entity have a semi-massive effect in a country, stock prices will react to published information nevertheless what principles or method were used in financial statements.

Literature (e.g. Bradshaw et al., 2006)) consisting many events proves that in many cases market participant did not reacted to changes of reports (performance, profit and loss statements) mainly owing to shift in used standards. For example: an economic entity changed its amortization method to achieve higher profit rate. Since market participant had enough information that the increase in profit was due to amortizing assets, stock price of given entity has not risen.

Similar effects could be experience in case of mergers and acquisitions in the USA (Feleage and Vasile, 2008). Since market participant were not touched by the fact, that increased profit was due to amortizing assets not performed before merge. Consequently standards should be used to eliminate manipulations, extra work caused by the alternations and unnecessary costs.

Another part of transaction costs are affected by international accounting standards, e.g.: costs connected to signing a loan contract or “so-called contract”. Accounting data may limit contracting parties’ freedom in the sense that how data could be used and represent their interest, e.g. information provided by loan contract on debtor’s engagement or limitation of the liability management.

Invoice of business tax may be mentioned as a theoretical example for “so-called contracts” since EBT (earnings before taxation) and EAT may differ significantly as later one is to be modified by accounting standards, rates and indexes. It is especially typical to the third sector where income is strongly affected by international accounting standards. Swann (2007) highlights the cost-saving effect of international accounting principles in connection with contracts since without theirs standards, lender would be forced into contracts that may push them toward bankruptcy.

Both lender and debtor prefer accurately defined obligations and demands that may be detailed by international accounting standards. Efficiency of loan contracts may be

increased by using more transparent, comprehensible and comparable reports based on international accounting standards since misconceived reports may lead to losses decreasing assets. These losses could be derived from false assessment of assets, obligations, consolidated profit or net assets. Since information on which reports are based may not be compensated from other resources, it motivates market participant to rely on such reports and decrease risk of investments by that.

In order to promote the outcome, a standard-setter must explain its view of the economics of transactions in the objectives to the standards. If there are competing views about how to faithfully represent the economics of a transactions, then the standard should state whether there is more than one acceptable treatment and why that conclusion was reached. Preparers and auditors could then use this information to reconcile the economics of a transaction to their understanding of the objectives of the standard-setter. Investors want to understand the fundamental judgments being made by preparers and external auditors. Under a more principles-based system, both preparers and auditors will increasingly be called upon to exercise sound judgment as a replacement for rigid adherence to the compliance process of a rules-based system. This is a positive development, as it will promote clear and understandable financial statements that faithfully reflect a company's economic condition. Yet at the same time, it is clear that a system which relies on judgment requires that those judgments be clearly communicated in order to ensure comparability

Applying international accounting standards may also decrease the costs of data processing systems since it supersedes to store and process differed data. The standardized the financial data base is, the higher the benefit gained. Decreasing risk connected to the operation if data processing systems may affects (decreases) stock prices since shareholders expect increase in performance. Unified international accounting principles may enhance cross-border investments, increasing their benefits. Since accounting standards may enhance the ability of forecasting profit rate, it could act as potential opportunity for investors.

The transaction costs of investors decrease with the steps taken in the direction of a single presence of stock markets, the disappearance of different national regulations. The costs regarding accounting, auditing and international comparison will decrease with uniform reports instead of expertise needed for the summarization of several types of reports and comparisons. With the use of numerous different accounting and reporting

standards, it is very difficult for companies to benchmark themselves against their competitors.

Businesses with foreign operations have to use different national accounting standards to complete their consolidated financial statements. Auditors (both internal and external auditors) have to be experts of each applicable national accounting standard or law of the multinational organizations' subsidiaries to be able to properly review and validate the accuracy of the company's financial reports. If the IFRS was adopted world-wide, auditors could work more effectively with significantly less people. Also, smaller audit firms could review and validate the financial statements of multinational companies. Currently the big four audit firms (Deloitte, E & Y, KPMG, PWC) seem to be auditing most of the big internationally recognized corporations as they have operations (with the necessary expertise) in almost all countries around the world. I believe that IFRS could bring increased competition in the auditing field, which could reduce the unavoidable audit costs.

Due to experts' opinions and impact studies, profit increasing effect of international accounting standards through cost-saving (transaction costs, costs of management) is proven.

13. INTERNATIONAL ACCOUNTING STANDARDS DECREASE COSTS OF CAPITAL

Practically speaking accounting is an instrument to project economic transactions and assess their performance. Particularly the later could be a remarkable tool for financial market participant if indicating accurate data on the financial situation, performance, mobility of resources, obligations due of examined business. Domestic investors prefer domestic business since report are created according to well-known international accounting standards and could be interpreted easily. On the other hand foreign investors prefer reports created on the basis of international standards rather than domestic standards. Costs of foreign investments could also be reduced if invested to the optimal opportunity where cost of managing active investments could be reduced to minimal level while maximizing profit.

About 1000 foreign companies registered at SEC, converted their accounting reports from their national accounting rules according to US GAAP and are listed and traded on the stock market of USA. But only some of them have such investment instruments (instrument of governance, ability to classify and account activities, ability to initiate claims) that are common used in the US, exposing their voluntarily to risk of being sued on the basis of insufficient investment-protection. Thus risk of exchanging stock may also increase the cost of capital since it is connected to the risk level of investment (decreasing risk factors results in the decrease of transaction cost emerging during investment). Risk may include the reliability of the accounting statements of business' financial position its performance. The cost-saving effects (through decreasing risk level of assets) of reliable and true financial statement is proven by numerous studies (including Butter et al., 2007, and Camfferman et al., 2006 researches) since reliability of accounting data effect on the prices of assets. The above mentioned studies have pointed out, that only that management could take effect on the cost of capital which has provided exact and reliable information to shareholders. Accordingly international accounting standards and unified methods could assist shareholders since unreliable reports could mean a possible risk-factor. This accounting model based on the principles of historical costs for invested vehicles distort it's the real value if late is defined as realizable income from cash flow applying financial resources. The invested vehicles receive criticism nowadays that may lead to the review of financial resources' evaluation. Necessity for re-evaluating applied international standards

of the financial instruments was suggested by expert due to present sub-primed mortgage and economic crisis.

Uniform financial reporting standards will result in a lowered cost of capital, because the investors are willing to accept lower returns (interest on debt, dividends, and capital appreciation on equity) from their investments in corporate securities. Investors can reach to lower returns when the perceived risk of their investments is reduced. Risk is a function of many factors, but accounting risk refers to the risk in investing that derives from difficulties in understanding the accounting principles being applied by the reporting entities, and the possibility that financial reporting standards may not be uniformly adhered to. Another aspect of accounting risk arises from the inability of users to process the information. If measurements and disclosures are of such complexity that the investors cannot understand this information when making decision, so they will perceive greater risk and should demand higher expected returns, therefore reaching a higher cost of capital too.

There is also risk based not on the underlying financial reporting principles, but on the confidence that the reporting entity has faithfully applied them. This depends on the investors' belief in the regulatory regime overseeing financial reporting (e.g. Security Exchange Commission – SEC – enforcement), and on the auditors' capabilities and willingness to enforce GAAP or IFRS rules. While auditors' honesty is challenged (such as Parmalat case had happened in Italy), the reluctance to confront clients opting for aggressive interpretations of accounting standards is more widely acknowledged. It is finding out, that the reducing accounting risk should have salutary effects on the cost of capital. A number of academic studies have investigated this premise, with overall positive, although there is not unanimous support for this proposition. Investor confidence in a given entity's financial reporting depends on more than the financial reporting standards it claims to subscribe to

For examining accounting standards from a different point of view confirmed the fact, that unreliable information used in reports may further increase cost of capital. The complexity and misconception of financial statements may cause higher risk factors resulting in longer rate of return and higher costs of capital. Without doubt it may be concluded that accounting risk could be lowered with the use of reliable and true international accounting standards.

If shareholders blindly trust in published reports may become a risk-factor as well. It also depends how shareholder trust in the regulations over financial statements (e.g.: SEC

in the USA), technical background and knowledge of auditors to enforce international accounting standards. Considering all factors mentioned above, it could be declared that increasing reliability and better interpretability of information provided in financial statements could decrease investors' cost of capital. Beside direct risk-factors, indirect risk-factors do also have effects on investors' cost of capital.

Reporting according to IFRS provide much better access to world capital markets, which reduces the cost of capital. Investors cannot easily interpret the given countries' national financial reports. They are very reluctant to invest in companies without clear financials. It is high risk to invest in companies without easily accessible, clear financial reports. Investors expect higher returns from these companies, thus the cost of debt is higher for companies not preparing IFRS reports. IFRS would put the financial statements in a simple and understandable form for investors and other businesses interested in the firm. IFRS financial statements could have a positive effect on companies' credit ratings thus the cost of borrowing may be reduced. Also, IFRS are widely accepted as the financial statements framework for companies who would like to get admitted to any of the world's stock exchanges. Since worldwide adoption of IFRS would create a common language for accounting, new capital markets would open to companies who have been reporting only in accordance with their national standards. One can easily say that companies have the opportunity to prepare their statements according to IFRS. However, small and middle size companies do not have enough funds and manpower to complete their financials both according to the national standards required by the law and according to IFRS, which would be desirable to enter the international capital markets.

In an increasingly global international environment a better developed international financial reporting system is becoming more important by the day. The advantages of more standardized national accounting rules and more comparable financial report are manifold. One of these advantages is the decreasing cost of capital. Investors may accept lower returns (interest on debt, dividends, and capital appreciation on equity) if on the other hand they only have to take lower risks. This is true if the international standards are properly enforced by the regulatory regime.

Investors can reach to lower returns when the perceived risk of their investments is reduced. Risk is a function of many factors, but accounting risk refers to the risk in investing that derives from difficulties in understanding the accounting principles being applied by reporting entities and the possibility of financial reporting standards may not be uniformly adhered to. Another aspect of accounting risk arises from the inability of users

to process the information. If measurements and disclosures are of such complexity that the investors cannot understand this information when making decision, so they will perceive greater risk and should demand higher expected returns, therefore reaching a higher cost of capital too. This risk is originated from that the accounting directions are not clear and unified used by the different companies.

It seems to be apparent that the appropriate accounting standards contribute to the division of labour, to financial innovation and to the reduction of the transactional costs, the cost of capital and even to the increase of the enterprises' earnings.

14. RESEARCH DESIGN

The purpose of this study was the measuring the differences between the national rules and the international methods by countries, then the valuing and analyzing their effects on the business environments. The author used Nelson's Directories of Investment Research for providing information on nearly 800 research businesses (especially multinational companies) around the world including the 67 member enterprises of Budapest Stock Exchange during the period of 2005 - 2008. He has chosen 400 of the biggest (by the total amount of their assets, net sales and employees) international European businesses (e.g. Daimler Chrysler, Allianz, ING, Gazprom, Arcelor, Credit Suisse, Deutsche Bank) and 300 multinational representative companies from the American, Asian and Australian Continents. The researcher adopted two approaches in this study. First approach involved identifying a list of 16 important accounting standards based on a review of the past literature and relying on a recent, comprehensive survey of General Accepted Accounting Principles (GAAP) differences. Secondly, the author has assigned 20 EU and 27 non EU member states – representing every continent excepting Africa - from where he could obtain accounting information. Because the tests examine the effects of GAAP differences between the business' local accounting rules and the international standards, it was excluded firm-years from the primary sample when businesses do not use local rules based on Worldscope yearly database. Worldscope data on the accounting standards used by the company are available for approximately one-half of the sample. In the primary test the author retain businesses that do not have data on the accounting rules used by the firms, reflecting the assumption that smaller businesses without standards data are very likely to be local rules users.

This survey contains information on how local GAAP differs from IAS on incorporating recognition, measurement, and disclosure rules. For each country, the survey captures next types of differences from IAS:

- absence of recognition and measurement rules that are present in IAS (e.g. many countries do not require international standards),
- absence of disclosure rules that are present in IAS (e.g. common disclosures that are called for under IAS but not required under local GAAP),
- inconsistencies between local GAAP and IAS that could lead to differences for many enterprises, and

- other issues that could lead to differences between local GAAP and IAS for certain enterprises.

14.1. THE ACCOUNTING PECULIARITIES OF THE MEMBER STATES OF EUROPEAN UNION

At first the author has chosen the eligible countries inside the European Union according to the research. In the study sixteen international standards content and characteristic were compared with the international accounting rules and standards. Five from these standards (1, 7, 8, 14, and 25) plays crucial part in the comparison of the accounting reports. The IAS 2 standard is to prescribe the accounting treatment for inventories, the IAS 17, 36, 38 standards are in connection with tangible and intangible assets, the IFRS 7 is regarding to the disclosure and presentation of the financial instruments, the IAS 19, 37 contains the regulations in connection with the other liabilities and debtors, the IAS 12 and IFRS 5 are details the special accounting practices, while IAS 27 and IFRS 3 is about the accounting of the Combinations by Contract, Alone or Involving Mutual Entities. Thus it can be concluded that the standards used in the sample are sufficiently represents all areas of accounting, particularly the rules about the set-up of the accounting report. He analyzed the member states of the European Union separately because the previous regulations (e.g.: the 1606/2002 on the application of IAS), directives (e.g.: 78/660/EEC, 83/349/EEC, 2006/43/EEC), communications (e.g.: COM/2003/283) and recommendations (e.g.: C/2000/3004) made by the EU were in order to implement the accounting harmonization and the common accounting principles. He compared the international standards with the national accounting principles and rules per its components. He only declared them as harmonized, if they show a complete match. These specifications were made with all 16 standards in case of all countries. He calculated the deviation between the international standards and the national regulations and principles in the eligible countries of the European Union in percentages and summarized it in Figure 1.

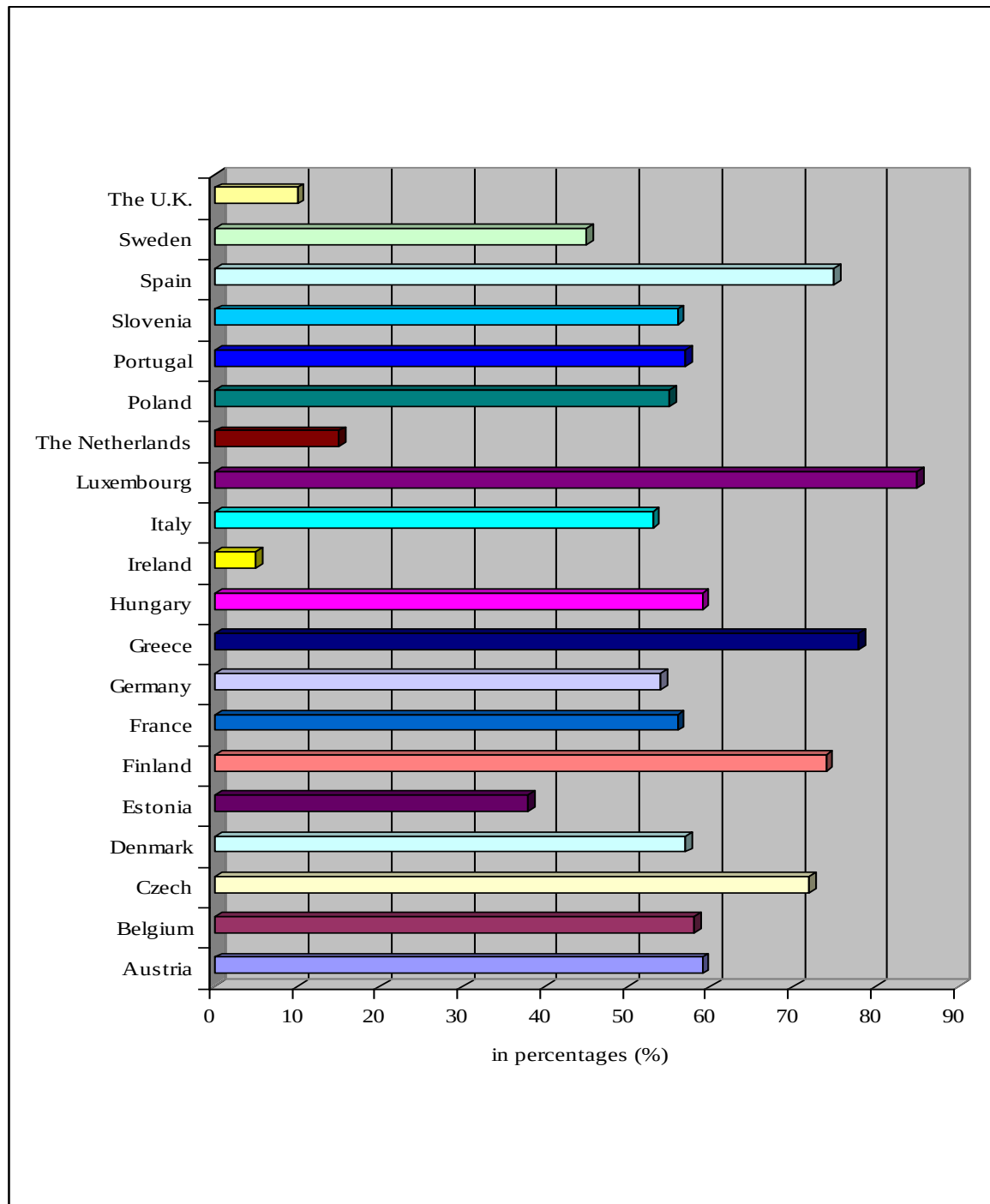


Figure 1: National accounting rules differences from IAS in the EU

Source: World Scope Database, Nelson's Directories of Investment Research

According to Figure 1 two opposite tendencies can be identified. In connection with the continental European countries the deviation from the international standards is greater than in case of the two island nations (Great Britain and Ireland). The greatest deviation from the international standards could be identified in the case of Luxembourg (over 80%). The Commission of the European Communities warned (e.g. the European Court's C-

115/05 judgement) its member nation to take provisions necessary to comply with Directive 2001/65/EC of the European Parliament regards the valuation rules for the annual and consolidated accounts of certain types of companies as well as of banks and other financial institutions.

Europe is the origin of many legal systems: English, German, French and Scandinavian. Prior to 2005, there were country-specific accounting systems. Therefore the EU issued several communiqués, commendations, directives to harmonize financial reporting practices to reduced diversity a facilitate cross-listings and cross-border investment.

The European Union countries have been divided into two groups depending on their finance, legal and tax systems. According to many researches, countries with a code-based legal system and with a business financing structure that is primarily based on banking, are characterized by a strong tax influence on accounting and therefore, by the presence of governmental rather than professional regulatory bodies. On the other hand, countries with a system based on common law and with a well-developed capital market have issued accounting rules independently from tax rules, under the auspices of professional bodies. Under these circumstances, we make the hypothesis that the investor-orientated legislation in common-law countries versus the creditor orientation of code-law countries will imply a higher value relevance of earnings than book value in common-law countries and vice versa. (Acre and Mora, 2002) The Netherlands, in spite of being a code-law country, has been typically included in the Anglo-American group due to the characteristics of its accounting system. So, for our purpose, we consider the UK and the Netherlands in the Anglo-American group and Belgium, France, Germany, Italy, Switzerland and Spain in the Continental group.

The classification of the national accounting systems it is possible to divide into two groups: those with significant equity markets and outside shareholders (the Anglo-Saxon model) and those with weak equity markets and few shareholders (continental European model). Consolidated (group) accounts drawn up under UK, US or international accounting standards would typically fall into the former group, while examples of the latter would include individual French, German and Italian accounts (Soderstrom and Sun, 2007).

Most of the Continental European Union member countries law system is based on the principles of the Roman law (jus civile). The codification of the law characterizes these countries. In such legal environment the adaptation and implementation of international

accounting standards into the national account system is much harder and takes longer time. Because of this and as the data of Figure 1 also shows us, the deviation from the international accounting standards are much bigger in these countries, although in a varying degree, than in the case of the island nations of the EU. Inside the accounting systems of the continental Europe we can differentiate three accounting cluster: Germanic, Latin and Scandinavian. The Germanic states (Austria, Germany, Hungary, Czech Republic) accounting system is in many ways differs from Anglo-Saxon and Scandinavian countries. For example the company and tax law in Germany plays a pivotal role on accounting. Also in Germany the Commercial Code contains the account reporting principles. Half of the German accounting principles differs from the international standards because their account law doesn't contains rules in connection with the effects of the exchange rates in case of the foreign based subsidiaries; the review of the value adjustment after the non-tangible assets lifespan exceeds the 20 year limit; the publishing commitments in case of the change in the Capital and reserves; the financial instruments valuation at fair value; disclosure commitments in case of related undertakings and the rate of dividend per share. There is no consistency in the accounting of business combinations, in the case of the accounting of leases grouped by tax provisions, and also in the evaluation of the assets.

It is obvious that the Anglo-Saxon (or Anglo-American) accounting system differs from the continental European, Asian, Latin-American or any other countries of the world. In case of the Anglo-Saxon countries the stock exchange plays a significant influential role in the national accounting practice, but not performs a cardinal role in the regulation process. In Great Britain the company law contains the necessary accounting requirements not just in case of the Limited Liability Companies but also for stock exchange listed companies. Besides not just the whole accounting profession but also, in lesser extent, the stock exchange participates in developing the national accounting regulation system. The country established its own professional bodies responsible for the regulation of accounting. One of these bodies is ASB (Accounting Standards Board), which has the authorization for issuing National Accounting Standards. The Accounting regulation works the same in Ireland too. The law system of the Anglo-Saxon countries (common law) does not containing rules in connection with the behaviour of the companies or the preparation of the annual accounts. In such circumstances accounting doesn't have a subordinate role. Instead the practical and theoretical accounting professionals creating standards very similar to the international ones, since the international standards are having a major effect

on their national standards. In such economic environment the adaptation and implementation of international accounting standards into the national account system is much easier and faster, than in the case of the Continental European countries introduced in the next paragraph.

The Hungarian accounting shows many similarities with the other continental, mainly Germanic, cluster members according to the place and classification. Our law system is similarly codified, so the accounting principles were also expressed by law. Since 1991 the interest of the owners and the creditors stands at the centre of the regulations also keeping the previous taxation goal. However the previously pivotal role of economic alignment and taxation is now gone. He will later discuss the classification of the individual standards, but hereby, according to the information from the domestic stock exchange listed companies and from personal consultations He can declare that the Hungarian account regulation, the budget system, our accounting principles and evaluation methods constitutes a solid ground for the establishment of an IFRS financial statement. From the balance drawn up according to the national rules only some corrections (e.g. depreciation calculation after Value Adjustment, the decreasing the Revaluation reserve with calculated depreciation cost of the Asset, moving the accrual capital's consolidation margin to the profit reserve) and renames (reclassification of the Accruals and deferred income and the Prepayments and accrued income, the reclassification of the property rights and Payments on account in course of construction) will lead us to the IFRS balance sheet. In case of our Statement of revenue the reclassification of the given discounts and refunds as turnover lowering and the received discounts and refunds as material cost lowering elements, furthermore the reclassification of the extraordinary elements and the value of the Allocations for depreciation higher with value of the depreciation after the value adjustment also leads us to the IFRS balance sheet. By the time of the socialist economic system the Hungarian accounting principles always followed the Hungarian economic regulation system and the modifications of the taxation system in the 1980's as a chapter of the law on national finances. After 1991 accounting became an individual act considered the European rules (directives), and from 2001, after its re-codification, the international principles as well. The Commission review before the entering to the EU (2004) declared that the Hungarian national accounting rules are compatible with the accounting principles of the EU. Although some financial "scandals" (Postabank in Hungary, Parmalat) derogated the faith towards accounting just like in the foreign countries, e.g. the USA (e.g. Enron in USA), but besides these effects our accounting regulation is stable and reliable.

Furthermore the national standards (leasing accounting, Inventories, Accounting policy regulations), developed in the last few years by the Ministry of Finance, can furthermore decrease the differences from the international standards.

The national regulations of the Latin cluster countries (Belgium, France, Italy, Portugal and Spain) shows several similarities with the Germanic cluster. Such as the pivotal role of the company and taxation law and also differs radically from the Anglo-Saxon characteristics. In France for example the codification rules are similar to the Napoleonic code (also in connection with accounting). In Italy, just like in other countries with conservative traditions, the accounting rules led the ventures to a minimized taxable profits and dividends. It is not unusual that the accounting information can serve for several different purposes (Management, Tax Authorities and Owners) simultaneously. The similarity between the national regulations of the countries in the Latin cluster also shows a minimum of 50%, but sometimes 80% (Spain) match to the international standards.

The EU states in the Scandinavian cluster (The Netherlands, Denmark, Sweden, Finland) also shows several conformity with the Anglo-Saxon countries but we can find some important Germanic effects as well, for example the importance of the tax legislation. Among the Scandinavian countries The Netherlands differs the least (only 15%) from the international standards. In Holland the impact of the micro-economical approach to the account is reasonable. Nevertheless the country also shows several similarities with the Anglo-Saxon characteristics. The pivotal role of the company law and the accounting profession is also measurable here. The civil law contains the company law which is based on the principles of Roman law. In this respect it shows analogy with the continental European countries, except for the civil law which traditionally not plays the role of a detailed regulatory system.

National General Accepted Accounting Principles (GAAP) in “code-law” countries were more frequently accused of abusing transparency due to legally imposed techniques such as statutory reserves, but failures even under “common-law” national GAAP’s have also been widely cited. But the IFRS-based financial reporting will ensure reasonable accomplishment of financial statement objectives. National GAAPs have commonly been categorized as being designed for either code law or common law traditions, with most continental European GAAPs and Japanese GAAP being examples of the former, and U.S. GAAP, U.K. GAAP and IFRS (which was largely derived from U.S.,U.K. GAAP) being typical of the latter. There is notably, that countries moving from code-law-based GAAP

to IFRS will experience a more substantial change in financial reporting standards than will those moving from common-law-based GAAP to IFRS.

14.2. THE ACCOUNTING PECULIARITIES OF THE COUNTRIES OUTSIDE OF THE EUROPEAN UNION

After analyzing the eligible EU countries, he presented the differences between the accounting principles of the American, Asian and African nations, the European countries outside the EU and also in Australia and New-Zealand and the international accounting standards (Figure 2).

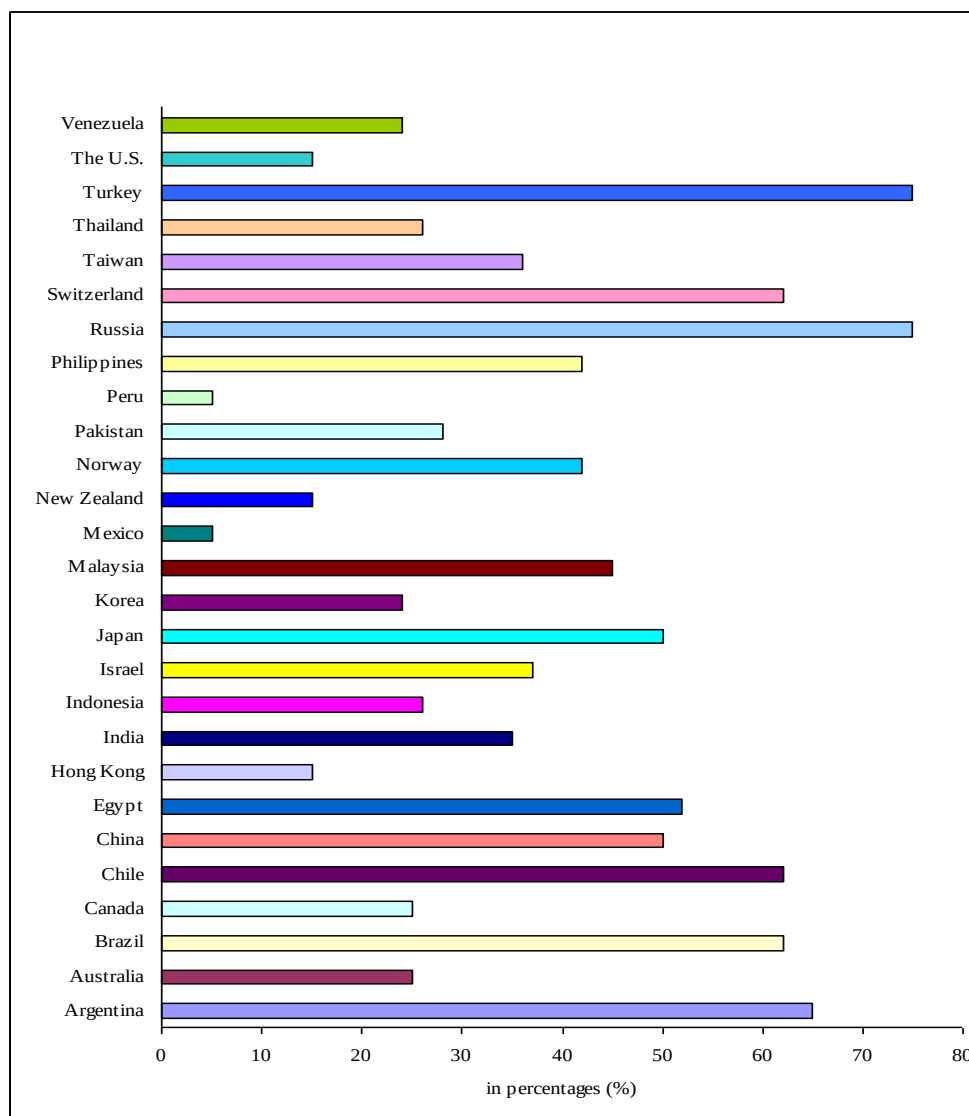


Figure 2: National accounting rules differences from IFRS outside of the EU
(Source: World Scope Database, Nelson's Directories of Investment Research)

Besides Russia and Turkey the differences are less (it's not reaching the 50% mark) than in case of the EU member states. Among the European countries Switzerland follows the Germanic accounting principles and its difference from the international standards is nearly the same (62%).

Swiss accounting is among the most conservative and secretive in Europe and the world today. As in Germany, Swiss accounting practice is dominated by company law and the tax regulations governing the accounting profession, which is small and still in the early stages of setting accounting standards. The legal requirements relating to accounting are modest and still permit the creation of secret reserves.

Norway's accounting principles reflecting Scandinavian effects and the deviation is similar to the Swedish. The Asian countries accounting rules follows the colonial specialities, so the impact of the colonizers is high. Thus in case Indonesia the Dutch, in case of India, Pakistan, Hong Kong and Malaysia the Anglo-Saxon and in the Philippines the Spanish and American impact is shown. In case of the Chinese accounting system it was both affected by western and the socialist Russian influence. A more micro-oriented decision-making approach is thus being encouraged that retains a measure of macroeconomic control – a difficult balance to strike given China's tradition of uniformity and detailed regulation. Moreover, this tradition appears to be consistent with established Chinese cultural values and hence will be difficult to change. The new accounting standards, structured as a basic standard and a series of specific standards, represent a major change of approach in Chinese accounting in that all enterprises are now required to comply with a unified set of accounting in that all enterprises are now required to comply with a unified set of accounting principles. In case of Japan we can notice both Germanic and American impact. Despite the significance of the stock market, the accounting tradition in Japan gives preference to the information needs and priorities of creditors and the tax authorities. The government has been a major influence on all aspects of accounting and the corporation tax law is another major, if not overriding, influence on income measurement practices in that corporate tax returns must be based on the annual accounts approved by shareholders. Government institutions are directly involved in accounting standard-setting. With accounting systems under the jurisdiction of two government institutions, there is no unified approach to regulation. In fact, a number of large listed corporations are obliged to prepare two sets of financial statements, one required by the commercial Code and the other by the Securities and Exchange Law. The accounting profession is small and has lacked influence in the accounting standard-setting process, but

it provides recommendations on the practical application of the legal accounting regulations (Radebaugh and Gray, 2007). However the Asian countries accounting systems are getting closer and closer to the Anglo-Saxon model.

The accounting in Argentina and Brazil follows the Latin rules and the difference is also similar (65%). As in France and Italy, the accounting tradition in Brazil gives preference to the information needs of creditors and the tax authorities. As in other Latin countries, the influences of government, company law, and the taxation regulations on accounting are fundamental importance. The accounting profession in Brazil is not as well developed as in the Anglo-Saxon countries, but the institute for Brazilian accountants issue accounting standards that form the basis of generally accepted accounting principles. The United States is famous for its accounting standards, which follows the Anglo-Saxon traditions and similarly to the British and Irish system it differs only in a small margin (15%) from the international standards. Mexico and Canada as former British possessions and members of the North American Free Trade Agreement (NAFTA) follows the Anglo-American (Anglo-Saxon) accounting principles. Australia and New-Zealand also as former British possessions follows the Anglo-Saxon accounting principles so the differences from the international accounting standards are rather small (15-25%).

14.3. EVALUATION OF THE CERTAIN ACCOUNTING STANDARDS

After evaluating the individual countries and the group of countries, the author has analysed the average differences in case of the certain accounting standards and what the background causes of these differences are. He displayed these differences in separate Figures 3. The researcher observed that the biggest average difference is detectable in case of the IFRS 7 (until 2007 IAS 30, 32) standard both within and outside the EU (82% and 68%), which standard is in connection with the disclosure and presentation of the financial instruments. The author remarked that in this case the certain countries were not claimed the disclosure and presentation of the financial assets and obligations on their fair value in their financial report as regulated in the accounting standard. This remark also stands in the case of Hungary. Hungarian national accounting regulations make the evaluation at fair value possible, but not compulsory. According to accounting practitioners only a few business choose this option. The personal consultations shows that this is because the tax consequences of this new model. Another typical difference is in connection the IAS 37 Provisions, Contingent Liabilities and Contingent Assets standard (68% and 80%).

Searching for the causes it turned out, that there are no national regulations in connection with the making of Provisions, furthermore it can be made in cases when there are no liabilities yet and there are no special rules of readjusting the Provisions. In case of the Hungarian regulation, the researcher found the two, previously mentioned differences. This is because our Act on account is not requires that the Provision could only originated from a previous events, furthermore Provisions can be made in advance in case of the periodically repetitive costs, and it also not using the Present Value. There is a significant difference in case of IFRS 5 (IAS 35 until 2005) Non-current Assets Held for Sale and Discontinued Operations standard (65% and 55%). In the international accounting there are no regulations referring to the Discontinued Operations. Neither our national act on account orders the information needed in case of the presentation of the Assets destined for sale or used in Discontinued Operations. It only orders the holder to demonstrate its future goals in the annual report which contains all the Discontinued Operations and the Assets destined for sale.

In case of the non EU countries the difference in connection with the IAS 19 Employee Benefits standard is also typical (65%). In case of the related EU countries this ratio is only 45%. The researcher missed the readiness of the regulations in connection with the cost of providing employee benefits and the costs above the pension benefits. In case of Hungary only the first half of the sentence stands. In case of the termination benefits the Hungarian regulation tries to follow the international standards. But we only admit the benefit as severance pay, which the employee gets in case the employer terminates his or her labour relation before the retirement period.

The difference between the national regulations and IAS 36 Impairment of Assets standard exceeds the 50% both in case of the EU member and non EU countries. Because in the national regulations there is no detailed rules on the testing of the impairment of the assets and the accounting of the impairment is only made after it declared durable. The Hungarian national regulation also differs from this standard, while it's not mentioning the external or internal signs of the impairment and the readjustment of the impairment, so there are no precise instructions regarding when to evaluate the "reference" value. Furthermore the category is not refers to the accounting date, but it relates the market value on the date of making the balance sheet to the book value on the accounting day.

We can see a difference of 55% relating to the IAS 1 Presentation of Financial Statement only in the case of the EU member states. The separate listing of the changes in the Capital and reserves is not present in the member state's accounting statement. This

deficiency is also mentioned in about Hungary. But in the notes on the accounts we must demonstrate the important changes in the Capital and reserves by entitlements. So in my opinion this should be considered not as a substantial, but a formal deficiency. Another 52% difference is stands within the EU in case of the IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors, and this stands also for Hungary, because it allows a broader interpretation of the unforeseeable event. Our act on account is not differentiates between accounting policy and accounting estimate. It considers the estimating as policy. The accounting policy contains rules relevant to stocktaking, money handling, evaluating, and net cost calculation. Furthermore all found errors must be corrected. In case of substantial error the corrected account must be represented. By contrast, the international regulations are not following this method.

Finally there are some smaller margin differences which affect mostly the EU member countries. Those standards are the IAS 24 Related Party Disclosures standard, which has an average deviation of 52%, and IAS 27 Consolidated and Separate Financial Statements standard with the average difference margin of 53%. The last deviation comes from the fact that there are no or just a small disclosure requirements in the national accounting regulations. The Hungarian act on accounting also misses the list of such events. However that kind of information must appear in the Notes on the account. In respect of the Consolidated and Separate Financial Statements the requirements towards consolidation of the special activity companies is missing. This deficiency not affected Hungary.

In case of the other standards the differences are much lower. Especially among the non EU countries (the average deviation is around 5-35%), but in case of the EU member countries the margins are still lower than 50% (around 22-35%). The smallest deviation we can recognize among the non EU countries is in the case of the IAS 7 Statement of Cash Flow standard (5%), while in case of the EU member countries it's the IAS 12 Income Taxes standard (22%). According to Hungary there were differences in case of standards Business Combinations, IAS 7 Statement of Cash Flows and IAS 38 Intangible Assets.

This research can record the following Notes according to the other standards.

- IAS 2 Inventories standard: In case of using LIFO asset-management and valuation method there were no disclosures of the related values at FIFO asset-management and valuation method (In case of Hungary it is not a problem because we use LIFO and average costing asset-management and valuation method),

- IAS 7 Statement of Cash Flow: The cash flow itself missing from some countries account regulation (Not in case of Hungary),
- IAS 14 Segment reporting: The segment reporting is not at all or just partly compulsory (In Hungary segment reporting is only mandatory for the stock exchange listed companies),
- IAS 17 Leases: The activation of the leases is missing or just partly done (In Hungary the leases must be shown only in case of tied and long term calls),
- IAS 38 Intangible Assets: The activation of Research and Development, Trademarks and Brand names (In case of Hungary the standard is consisted as harmonized).

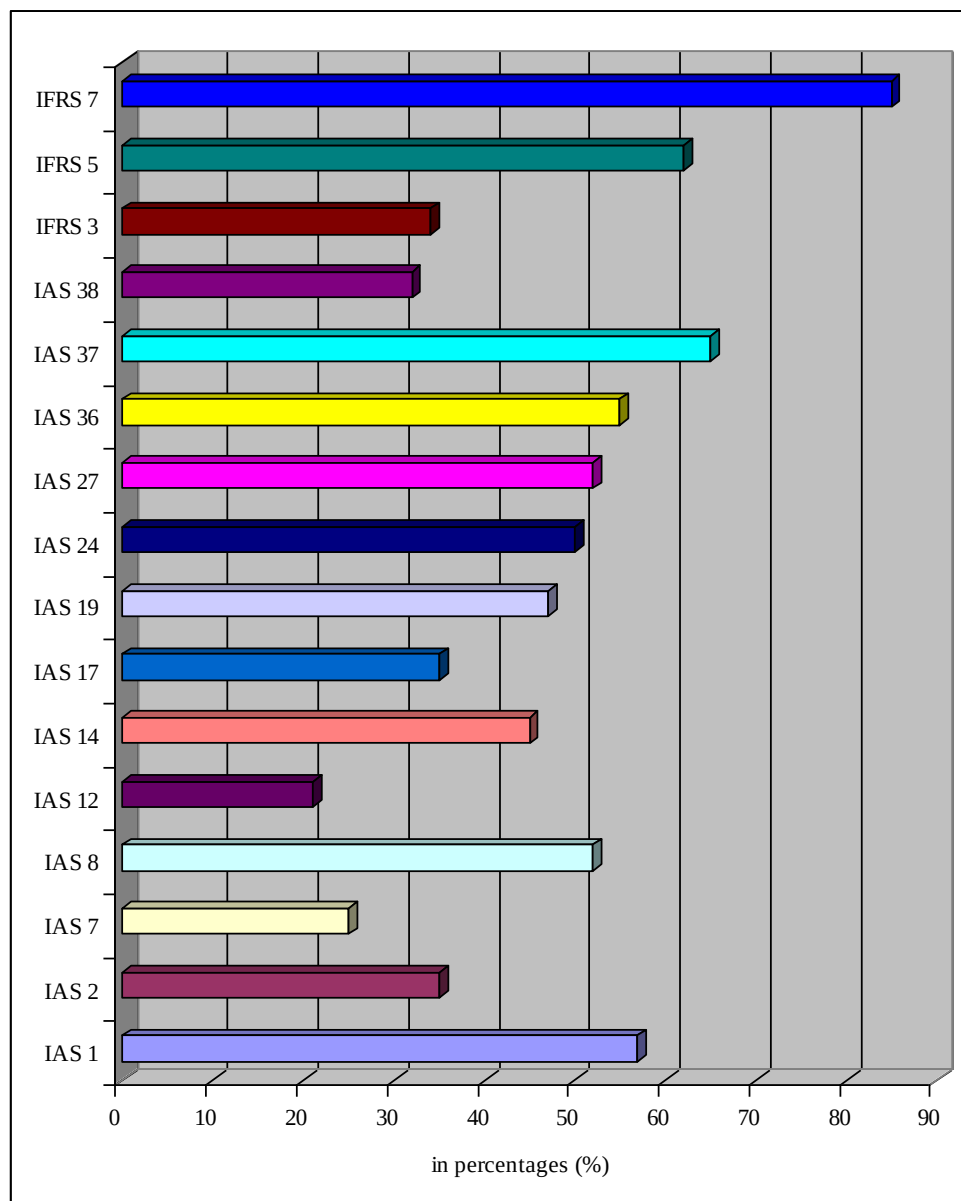


Figure 3: National accounting rules differences from IAS by standards

(Source: World Scope Database, Nelson's Directories of Investment Research)

15. METHODOLOGY

My research is based on a qualitative comparative approach. In order to identify the results of my scientific research about the evaluation of the accounting standards in Hungary I have elaborated the following hypotheses:

- H1:** Businesses with lower labour productivity compared to their industry peers have greater incentives to adopt international accounting standards.
- H2:** The sensitivity of CEO turnover to accounting earnings increases after the adoption of international accounting standards. Earnings and stock returns affect management turnover.
- H3:** The sensitivities of employee layoffs to accounting earnings are before and after the adoption of international accounting standards.

The purpose of this study was the measuring the differences between the national rules and the international methods, the valuing and analyzing their effects on the business decisions. This survey contains information on how local, national accounting rules differ from IFRS on incorporating recognition, measurement, and disclosure rules.

To analyze business adoption decision my sample consists of Budapest Exchange Trade (BET) companies who compulsory adopted international financial reporting standards from 2005. My final sample comprises 65 IFRS adopting and 260 local (Hungarian) accounting rules firms. For the chosen of the national accounting rules user enterprises I introduced mathematic-statistic methods. An alternative approach it to create a matched sample of local rules businesses based on criteria such as year and industry. It is chosen to incorporate all local rules firms due to methodological concerns about the matched-pairs research design. Financial data are from published accounting statements in BET and Hungarian Business Information database. In my sample the businesses are classified into those following IFRS and those following national accounting rules. For the IFRS adopting enterprises the adoption year is treated as event year 0. To analyze enterprises' adoption decision, I required data on stock returns, accounting earnings, total assets, market capitalization, leverage, growth, foreign sales, and sales per employee one year prior to event year 0, and closely held shares for event year 0. *Close_Held* is measured in event year 0.

The adoption decision models are expanded relying Nobes (2006) researches and test if the demand from internal performance evaluations is a factor in businesses decisions to adopt international accounting standards.

It is estimated in the following logistic regression model (1) after the prior literature (Wu and Zhang, 2009):

$$\begin{aligned} \text{Prob [Adopt=1]} = \text{Logit} (a_0 + a_1 \text{Close_Held}_0 + a_2 \text{Labor_Prod}_{-1} + a_3 \text{RET}_{-1} \\ + a_4 \text{ROA}_{-1} + a_5 \text{Size}_{-1} + a_6 \text{Lev}_{-1} + a_7 \text{Growth}_{-1} \\ + a_8 \text{Foreign_Sales}_{-1}). \end{aligned} \quad (1)$$

Where:

Close Held: Percentage of closely held shares at the end of event year (event year of 2008 for the management turnover and employee layoffs analyses)

Labour Prod: Labour productivity (sales per employee) minus the median labour productivity

RET: Annual raw stock return

ROA: Return on Assets, accounting earnings is defined as net income before extraordinary items.

Size: Natural logarithm of market capitalization

Lev: Leverage, defined as long-term debt divided by total assets

Growth: Sales growth, current year's sales change divided by prior year's sales

Foreign Sales: Foreign sales divided by total sales.

The dependent variable *Adopt* is equal to 1 for adopting firms and 0 otherwise. All the independent variables are measured around event year 0. This model includes year and industry dummy variables.

It included lagged variables on businesses performance (RET_{-1} and ROA_{-1}), firm size (Size_{-1}), leverage (Lev_{-1}), growth (Growth_{-1}) on the right-hand side of the regression model and I expected the coefficients on firm size, leverage and growth to be positive. I also included foreign sales as a percentage of enterprise total sales ($\text{Foreign_Sales}_{-1}$). I expected these variables to have positive signs.

The regression results are reported in Table 1. Table 1 reports the logistic reports to model business decisions to adopt IFRS. In Table 1 the coefficients estimates, standard errors, and the marginal effects are reported in columns (1) to (3), respectively. The Close_Held_0 has a negative coefficient, -0.00445, and significant at the 0.05 level. The marginal effect suggests that a one standard deviation increase in the percentage of closely held shares decreases the adoption likelihood by 0.64 percent.

Table 1. Logistic analysis of accounting standards adoption decision

Analysis	Estimate	Standard Error	Marginal Effects*
Close_Held ₀	-0.00445	0.0026**	-0.64%
Labor_Prod ₁	-0.00005	0.0003 **	-1.08%
RET ₁	-0.1134	0.1447	-0.30%
ROA ₁	-0.5609	0.7148	-0.31%
Size ₁	0.2659	0.0461***	4.21%
Lev ₁	1.3004	0.4882***	1.12%
Growth ₁	-0.2883	0.2021	-0.50%
Foreign_ Sales ₁	1.2085	0.2301***	3.08%

(Source: Author's own construction)

*** ,*** Indicate that a coefficient is significantly different from zero at the 10 percent, 5 percent, 1 percent levels, respectively (one-sided tests for coefficients with predictions and two-sided tests for those without a prediction)*

**Marginal effects measure the changes in the predicted probability from a one standard deviation increase from the mean for a continuous variable and form 0 to 1 for an indicator variable with the other variables measured at the mean.*

The percentage of closely held shares can also vary with business' incentives to access the capital market as more closely held business may have lower demand for external capital. This is the reason why the research controls for various factors related to business financing needs in the regression model.

The coefficient on *Labor_Prod₁* is -0.00005 negative as expected and significant at the 0.05 level. The marginal effect indicates that a one standard deviation increase in labour productivity reduces the likelihood of adoption by 1.08 percent. Regression has reasonable predictive power with a Pseudo R² of 32 percentages.

I analyzed CEO turnover-to-performance sensitivities separately for the adopting standards and the national rules samples using model (2):

$$\begin{aligned} \text{Prob [CEO_Turnover}_t = 1] = & \text{Logit} (a_0 + a_1 \text{DROA}_{t-1} + a_2 \text{DRET}_{t-1} \\ & + a_3 \text{Post} + a_4 \text{Post} * \text{DROA}_{t-1} + a_5 \text{Post} * \text{DRET}_{t-1} \\ & + \sum b_j \text{Control variable}_j). \end{aligned} \quad (2)$$

Where:

CEO_Turnover: 1 if there is a CEO turnover in event year t ; 0 otherwise.

DROA: 1 if ROA of event year $t-1$ is negative and 0 otherwise.

DRET: 1 if annual stock return of event year $t-1$ is less than 20% and 0 otherwise.

Post: 1 if a firm-year observation is post-event year 0, and 0 for pre-event year 0 observations (event year 0 itself is removed).

The dependent variable, *CEO_Turnover_t*, is an indicator equal to 1 if there is a CEO turnover in year t and 0 otherwise. *Post* is an indicator variable, equal to 1 if the firm-year is post-event year 0, and 0 otherwise (event year 0 itself is removed from the analysis). The study includes the explanatory variables from the earlier adoption decision regression (except for *ROA* and *RET*) to control for business incentives to adopt international accounting standards and their potential impact on CEO turnover. These variables are measured around year t . The results for model (2) are reported in Table 2.

Table 2. CEO turnover-to-performance sensitivity analysis

Analysis	Standards adopter enterprises		Local rules user enterprises	
	Estimate	Standard Error	Estimate	Standard Error
DROA_{t-1}	-0.2611	0.2469	0.2249	0.2055
DRET_{t-1}	0.0221	0.2449	0.3002**	0.0522
Post_t	-0.0415	0.1456	0.0110	0.0928
$\text{Post}_t * \text{DROA}_{t-1}$	0.8062***	0.3092	-0.0175	0.2473
$\text{Post}_t * \text{DRET}_{t-1}$	0.0810	0.1960	-0.0708	0.1961
Close_Held_t	0.0007	0.1965	0.0026	0.1935
Labour_Prod_{t-1}	-0.0001	0.0002	0.0001	0.0001
Size_{t-1}	0.0857**	0.0406	0.0391	0.0345
Lev_{t-1}	-0.5109	0.5521	0.0282	0.3062
Growth_{t-1}	-0.2152	0.4063	-0.4028*	0.2749
$\text{Foreign_Sales}_{t-1}$	-0.2949	0.2092	-0.0234	0.1710

(Source: Author's own construction)

*, **, *** Indicate that a coefficient is significantly different from zero at the 10 per cent, 5 per cent, 1 per cent levels, respectively (one-sided tests for coefficients with predictions and two-sided tests for those without a prediction).

I expected a positive coefficient on $Post \cdot DROA_{t-1}$ for the adopting sample and negative for local accounting rules businesses.

The insignificant coefficient on $Post \cdot DRET_{t-1}$ is inconsistent with an overall increase in the performance sensitivities of CEO turnover at the adopting firms that might result from concurrent organizational changes other than accounting changes.

The next model (3) is an analysis of layoff-to-performance sensitivities separately for the adopting standards and local rules samples.

$$\begin{aligned} \text{Prob} [\text{Layoff}_t = 1] = \text{Logit} (a_0 + a_1 DROA_{t-1} + a_2 DRET_{t-1} + a_3 \text{Post} \\ + a_4 \text{Post} \cdot DROA_{t-1} + a_5 \text{Post} \cdot DRET_{t-1} \\ + \sum b_j \text{Control variable}_j \end{aligned} \quad (3)$$

The dependent variable, $Layoff_t$, is an indicator, equal to 1 if there is a reduction of a business employee headcount of more than 5 per cent in year t , and 0 otherwise. The explanatory variables on the right-hand side are the same as those in model (2) on management turnover, except for the addition of several control variables. Since the change in employee headcount can reflect contemporaneous changes in a business' overall scale of operations, the study includes sales growth ($Growth$), change in foreign sales ($\Delta Foreign_Sales$), and an indicator variable for fixed assets disposal ($Fix_Disposal$), for year t . The results for model (3) are reported in Table 3.

Table 3. Employee Layoff-to-Performance Sensitivity Analysis

Analysis	Standards adopter enterprises		Local rules user enterprises	
	Estimate	Standard Error	Estimate	Standard Error
$DROA_{t-1}$	0.2805*	0.1838	0.5126***	0.0844
$DRET_{t-1}$	0.2016**	0.1050	0.1885**	0.0592
$Post_t$	0.0269	0.1162	0.0386	0.0432
$Post_t * DROA_{t-1}$	0.5345**	0.2628	0.0034	0.0973
$Post_t * DRET_{t-1}$	0.1968	0.1403	0.0783	0.0682
$Close_Held_t$	0.0033*	0.1985	0.0009	0.0765
$Labour_Prod_{t-1}$	-0.0006	0.0004	-0.0001**	0.0001
$Size_{t-1}$	-0.0177	0.0289	-0.0274**	0.0131
Lev_{t-1}	0.3978	0.3831	0.3193**	0.1353
$Growth_{t-1}$	-0.1266	0.2115	-0.3034***	0.0863
$Foreign_Sales_{t-1}$	-0.0563	0.1546	0.0354	0.0630
$\Delta Foreign_Sales_t$	-0.2631	0.6219	-0.3361	0.2683

(Source: Author's own construction)

**The estimation results*

,Indicate that a coefficient is significantly different from zero at the 10 percent, 5 percent, 1 percent levels, respectively (one-sided tests for coefficients with predictions and two-sided tests for those without a prediction).*

16. ACCOUNTING METHODS AND BALANCE SHEET EFFECTS

This set of analyses measures how Hungarian enterprises have been affected in terms of business performance by IFRS. The logistic regression models employed are (see *Barth et al.*, 2005):

$$RR_{i,t} = a_0 + a_1 Size_{i,t} + a_2 Dividend_{i,t} + a_3 Growth_{i,t} + a_4 Profitability_{i,t} + a_5 Liquidity_{i,t} + a_6 Leverage_{i,t} + ei_{i,t} \quad (1)$$

$$PA_{i,t} = a_0 + a_1 Size_{i,t} + a_2 Dividend_{i,t} + a_3 Growth_{i,t} + a_4 Profitability_{i,t} + a_5 Liquidity_{i,t} + a_6 Leverage_{i,t} + ei_{i,t} \quad (2)$$

Where:

$RR_{i,t}$ = dummy variable, indicating the regulatory system,

- $RR_{i,t} = 1$, financial numbers are reported by IFRS
- $RR_{i,t} = 0$, financial numbers are reported by National GAAP

$PA_{i,t}$ = dummy variable, indicating the post-adoption effects.

- $PA_{i,t} = 1$, financial numbers are reported by IFRS in 2005
- $PA_{i,t} = 0$, financial numbers are reported by IFRS in 2004

Size: Natural logarithm of market capitalization:

- NAVSH: Net asset value per share
- RESSFU: Reserves to shareholders' funds

Dividend:

- DIVCOV: Dividend cover
- DIVSH: Dividend per share
- DIVYI: Dividend yield

Growth: - MVBV: Market value to book value

Profitability:

- EPS: Earnings per share
- NPM: Net profit margin
- ROCE: Return on capital employed

Liquidity:

- CFM: Cash flow margin
- CUR: Current ratio
- OCF: Operating cash flow scaled by total assets
- QUI: Quick ratio
- WCR: Working capital ratio

Leverage: - DEBTE: Debt to equity

- DSFU: Debt to shareholders' funds
- CGEAR: Capital gearing

$e_{i,t}$ = the error term.

16.1. ACCOUNTING METHODS AND P&L EFFECTS

This part of our research examined whether firms determine small positive profits rather than large losses. Our analysis employed the next model (see also *Iatridis and Rouvolis, 2010*):

$$RR_{i,t} = a_0 + a_1 Profitability_{i,t} + a_2 Dividend_{i,t} + a_3 Growth_{i,t} + a_4 Size_{i,t} + a_5 Liquidity_{i,t} + a_6 Leverage_{i,t} + a_7 SP_{i,t} + a_8 LL_{i,t} + e_{i,t}$$

(3)

Where:

$SP_{i,t}$ = dummy variable indicating a measure of small positive profits

$SP_{i,t} = 1$ if net profit scaled by total assets is between 0 and 0.01

$SP_{i,t} = 0$ otherwise

$LL_{i,t}$ = dummy variable indicating a measure of timely loss recognition

$LL_{i,t} = 1$ if net profit scaled by total assets is less than - 0.20

$LL_{i,t} = 0$ otherwise.

16.2. ACCOUNTING METHODS AND VALUE RELEVANCE

The first value relevance test is an OLS regression of share price on book value per share and net profit per share (see *Hung and Subramanyam, 2007*):

$$P_{i,t} = a_0 + a_1 BVPS_{i,t} + a_2 NPPS_{i,t} + e_{i,t} \quad (4)$$

Where:

$P_{i,t}$ = Total market value of equity deflated by number of shares outstanding

$BVPS_{i,t}$ = Total book value of equity deflated by number of shares outstanding

$NPPS_{i,t}$ = Total net profit deflated by number of shares outstanding.

The second value relevance test is an OLS regression of profits on stock returns:

$$NPP_{i,t} = a_0 + a_1 AR_{i,t} + e_{i,t} \quad (5)$$

Where:

$NPP_{i,t}$ = Net profit divided by beginning of year share price

$AR_{i,t}$ = Annual stock return at year-end.

The third value relevance test measured the association between IFRS-based book value and net profit figures, then stock returns:

$$AR_{i,t} = a_0 + a_1 BVPS_{i,t} + a_2 BVCHA_{i,t} + a_3 NPPS_{i,t} + a_4 NPCHA_{i,t} + e_{i,t} \quad (6)$$

Where::

$BVCHA_{i,t}$ = Variable indicating the change in corporate book value following the transition

to IFRS

$NPCHA_{i,t}$ = Variable indicating the change in corporate net profits following the transition to IFRS.

16.3. RESULTS

The results of hypotheses H_1 are reported in Table 4.

Table 4. Accounting method effects

Denomination	Firms using domestic GAAP		Firms adopted IFRS	
	Mean	Std. deviation	Mean	Std. deviation
DIVSH	0.0846	0.1986	0.1557	0.2106
DIVYI	17.5764	19.8721	22.8705	25.4457
MVBV	5.8152	7.8125	2.5478	8.1547
NPM	-0.2945	4.5412	-0.1031	7.4581
EPS	0.1987	1.0561	0.1897	1.5061
ROCE	0.2008	0.3051	-0.0081	0.6401
OCF	3.8812	15.4421	4.8512	16.8041
CUR	1.9911	6.9105	2.9814	3.1125
CFM	0.8029	2.3126	-0.0408	1.5974
DEBTE	1.9843	2.3566	2.3099	2.1577
CGEAR	0.3454	0.2325	0.8714	0.3115
DSFU	0.3258	0.1353	0.5469	0.8540

(Source: Author's own constructions.)

It can be seen in Table 1 that the average index of dividend per share (from earnings after tax) is higher at companies which had already adopted IFRS than in others. However, the relative average value (DIVYI) contains a high deviation (the deviation value is almost 30 in respect of companies using IFRS).

The companies applying National Accounting Rules earn more than double (5.8152) in terms of growth (measured by market value to historical value of assets) than do other firms. In this sense the IFRS-adopting companies' average index is much lower.

The companies examined had a negative average net profit value (loss) in both groups in the period covered, although the return on equity and the average return on capital employed gave better results for National Accounting Rules users. The latter index showed a declining tendency (-0.0081) at companies which adopted the IFRS.

The National Accounting Rules-using companies' average indices measuring solvency (OCF, CUR, CFM) and leverage were higher than the others. Cash Flow, for instance, decreased (-0,0408) at IFRS-adopting companies, although around the relative average value of Operating Cash Flow on assets the deviation is quite high (between 15

and 17). As the indebtedness of companies using national regulations was lower, the leverage indices (DEBTE, CGEAR, DSFU) were better than in those companies which had adopted IFRS.

To summarize, we can state that balance sheet indices deteriorated especially regarding solvency and prosperity after the adoption of IFRS.

The results of model are reported in Table 5.

Table 5. Small Profit or Large Losses

Denomination	IFRS adopted firms	Domestic GAAP-using firms
SP	-1.194**	0.451
LL	2.581*	1.324

(Source: Author's own constructions.)

** at 10% level significance, **at 5% level significance..*

Data in the Table 2 prove that the companies which had already adopted IFRS were less willing to hide profit in the P&L account when it was low, and by doing so, the probability of reporting a small profit (SP) was significantly negative (-1.194) in their case.

Further we can state that neither tended to hide a large loss. The latter statement is a consequence of the positive and high value of the coefficient of LL (2.581). It is specific for National Accounting Rules-using companies to favour reporting smaller profits (0.451) and avoid large losses being reported in P&L account – which is possible when using accrual-based accounting.

The results of value relevance models are summarized in Table 6.

Table 6. Accounting methods and value relevance

Denomination	Coefficients	
	Firms using domestic GAAP	Firms adopting IFRS
NPPS	2.041**	3.025**
BVPS	0.547**	1.354**
AR	2841.145**	3694.124*
BVCHA	0.1941**	0.2941*
NPCHA	0.0182**	1.3541
R ²	0.689	0.799
*Statistical significance at 10% level, **Statistical significance at 1% level.		

(Source: Author's own construction.)

Our H₃ assumption, namely, that the information system of companies that adapted IFRS shows a higher value relevance than other national accounting rules-using companies, is proved by the data of Table 3.

The first test of value relevance gave a result for earnings after tax/share (EPS) coefficient (3.025) and for book value of equity/share (1.354) which is significantly (at 1 %) positive and higher at IFRS-adopting companies than at others. These companies also had more profitable, higher correlation coefficients of financial indices ($R^2 = 0.799$).

The second test of value relevance gave similar results since the coefficient of Return on Equity (ROE) is also significantly (at 10 %) positive and higher (3694.124) at companies which have already adopted IFRS.

The coefficient of Book Value Change (1.3541) produced turned out significantly more positive at IFRS-adopting companies according to the third test of value relevance. These results obviously prove that the companies which adopted IFRS have an orientation towards a reporting policy based on greater reliability and more realistic evaluation. However, the index presenting the change of Net Profit (NPCHA) was also positive (but not significantly) at these companies (1.3541).

17. EMPIRICAL RESULTS

The results showed that businesses with lower labour productivity compared to their industry peers have greater incentives to adopt international accounting standards. As hypothesis 1 predicted that businesses face a better need for informative measures of enterprises performance to facilitate internal performance evaluation, therefore a higher probability of international standards. It was expected that the coefficients on the percentage of closely held shares (*Close_Held₀*) and labour productivity (industry-adjusted sales per employee, (*Labor_Prod₋₁*) variables to be negative, because prior research suggested that these variables associated with disclosure incentives have predictive power for the adoption decision (e.g. Whittington, 2008, Schleifer and Vishny, 2003). The control variables signed that larger businesses, those with higher leverage, with more substantial foreign sales are more likely to adopt international standards. I found that *Close_Held* are consistent with compensation contracting demands affecting business decisions to adopt international accounting standards.

The marginal effect suggest that a one standard deviation increase in the percentage of closely held shares decreases the adoption likelihood by 1,25 percent, or 5 percent of unconditional adoption probability of 20 percent (65/325). This supports a greater demand for more informative and conservative accounting earnings due to management performance evaluations at more widely held by businesses stimulating to adopt international accounting standards.

Hypothesis 2 is certified that the sensitivity of CEO turnover to accounting earnings increased after the adoption of international accounting standards, because both earnings and stock returns affected management turnover. In my management turnover test the indicator variable *DROA* equal 1 and the stock return 17 percent (below 20 percent). But the accounting earnings are timelier, less managed, and more conservative after the adoption of international accounting standards. Also they are more effective tools for businesses internal performance evaluations and governance as I found in my research too. The study showed that both business earnings and stock returns have effects on the management turnover. Controlling for the effects of macro-economic conditions and employee layoffs by including the market return in Hungary it was pointed that the coefficients on market returns had been insignificant in the various regressions. Analyzing the changes in labour productivity at the adopting businesses the tests did not show a

significant decreasing in the productivity over the last 5 years. It could be that businesses' labour productivity is persistently low, not necessarily deteriorating continuously, in the several years leading up to the adoption. Meanwhile, there is a significant increase in labour productivity over event years.

I measured earnings and stock performances with indicator variables of negative Return on Assets (ROA) and stock returns, respectively. The indicators with continuous measures of ROA and stock returns were replaced. The inferences on employee layoffs are unaffected. However, the results on turnover are sensitive to this change in variable specification. This suggests that the increase in the sensitivity of turnover to accounting performance post-adoption is primarily driven by heightened turnover sensitivity to accounting losses. The prior studies suggested that variables associated with disclosure incentives have predictive power for the adoption decision and showed that both earnings and stock returns affect management turnover (see, for example, Easton, 2006).

Hypothesis 3 is certified in my tests that the employee layoff sensitivity to poor accounting performance increased after the adoption of international accounting standards. The adopting firms' employee layoffs are more response to accounting performance post-adoption. With respect to the control variables, the study founded that businesses with higher labour productivity, that are larger, with greater contemporaneous and lagged sales growth, and less frequent layoffs. On the other hand, businesses with higher leverage, with divestitures have more frequent employee layoffs. Continental European countries are known for their strong employment protection laws and powerful labour unions (Zeff, 2006).

The empirical results of measuring and analyzing in details their pros and cons effects on the business environment there could be the author's suggestions for business management.

18. CONCLUSIONS

The present impetus for global accounting information system follows the accelerating integration of the world economy. The application of international financial reporting standards will allow greater comparison of international financial results. The unified accounting information system will probably lead to new types of analysis and data; furthermore, with the possible integration of new indicators from the practice of certain countries.

The accounting information system differences matter even to financial analysts who specialize in collecting, measuring and disseminating business information about the covered companies suggests that there are potential economic costs, associated with variation in national rules across countries. Besides, it is very important task for managers and researchers the valuation and analyzing the effects of international accounting standards on the business environment, especially their contribution to harmonization and globalization. While a large body of this study is devoted to understanding the causes and consequences of the adoption of international accounting standards, researcher' attention has thus, far focused almost exclusively on the informational benefits for the business environments, like evolution of business turnover, employees and the management performance.

There is certainly empirical research evidence to support the notion that uniform management accounting standards will increase market liquidity, decrease transaction costs for investors, lower cost of capital, and facilitate international capital formation and flow. Reduced costs will also result in more cross-listings and cross-border investments. International standards also have a good effect on the division of labour too. And there is a sufficient basis to endorse international standards and begin the challenging task of educating users, auditors, and regulators. Educators and practicing accountants alike have significant roles to play in this exciting future.

My research paper investigates the effects of international accounting system on business decisions, management performance and economic environment. The sensitivity of CEO turnover to accounting earnings increased after the adoption of international accounting system. The employee layoffs are more responsive to poor accounting performance post-adoption. The firms with higher leverage and divestitures have more frequent employee layoffs. Companies with more substantial foreign sales are better likely to adopt international accounting system.

Standardization of financial accounting has tended to follow the integration of the markets served by the accounts. The global accounting standards would enable the world's stock markets to become more closely integrated. The more closely world's stock markets approach a single market, therefore, the lower should be the transaction costs for investors and the cost of capital for firms in that market. The differences in international reporting practice prior to IFRS constituted a palpable barrier to efficient international investment, monitoring and contracting. Literature suggest that being confined to small segmented capital markets imposes a substantially larger cost of capital on firms and transaction costs on investors, which would inhibit much worthwhile investment. Although we do not have all elements for the cost-benefit calculation, the evidence points to substantial net gains for smaller economies which have joined to the IFRS regime. There is certainly empirical research evidence to support the notion that uniform financial reporting standards will increase market liquidity, decrease transaction costs for investors, lower cost of capital, and facilitate international capital formation and flow. And there is a sufficient basis to endorse IFRS and begin the challenging task of educating users, auditors, and regulators. Educators and practicing accountants alike have significant roles to play in this exciting future.

Unified international accounting information system creates more transparency on the financial market. This provides investors more accurate information on company profiles. This way, even small investors (and not only professionals) will be able to get the information needed for their investment choices, thus they will be able to better compete on the market. More transparency will result in more international transactions that will have reduced costs because of the clear information provided by companies' reports. In case of consolidated accounts (when the company has foreign subsidiaries) bookkeeping will be facilitated and will also result in reduced transaction costs. No more adjustments will be needed in order to make financial reports of companies internationally comparable. Reduced costs will also result in more cross-listings and cross-border investments. International accounting standards also have a good effect on the division of labour. These standards and thus the less transaction costs will enable companies to be able to trade easier between each other. This will let them specialise in the field of their strengths and rather rely on suppliers that are also specialists in another field of their own than trying to produce the same product in-house, which will create a division of labour on the market. Accounting standards also provide information on company disclosure. Better transparency, by providing more information, and providing the accurate and

understandable information will reduce the risk perceived by investors. The risk in question is the accounting risk that comes from the difficulties in understanding the accounting principles and standards applied by the firm, and also the inability of investors to process the information provided. By reduced risk investors will get lower returns from their investments that will result in lower cost of capital as well. Businesses that are using IFRS face less earning management, more earnings and more value relevance of earnings. This can be due to the easier flow of capital, the less costs attributable to the difficulties of adjusting the reports of companies from different accounting systems. Due to the decreasing costs of processing the information provided in financial statements the efficiency of stock markets will increase which will result in greater prices of stocks and thus greater capital income for enterprises. These all will provide space for more innovation on the financial markets because they could become more integrated, and more and new international transactions could be created. Due to accounting standards, the international flow of capital will be easier.

It seems to be apparent that the appropriate international accounting information system contributes to the division of labour, to financial innovation and to the reduction of the cost of capital and even to the increase of the businesses' earnings. The first argument for the harmonization of accounting standards is the existence of the multinational companies, who invest enormous efforts into the preparation of their financial statements in order to comply with the national standards. For these companies life would be much easier if the same rules would apply to their subsidiaries all around the world. On the other hand this would be profitable for the investors as well, as they could compare the enterprises' results without difficulties, which would spare both money and other resources for them. This would also lead to the reduction of the information asymmetry between managers and investors. The information asymmetry is a costly thing which can be blamed for the increase of the equity's cost and the inaccuracy of the economical and the financial forecasts. So the aim of the international accounting systems is that similar transactions are treated the same way all around the globe which enables the creation of unified financial statements.

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ATTACHMENTS

I.

Distribution of Adopting and Local Accounting Standards Firms by Home:

<u>Country</u>	<u>Adopting firms</u>		<u>Local Standards firms</u>	
	<u>Number of firms</u>	<u>Percent</u>	<u>Number of firms</u>	<u>Percent</u>
Austria	12	6.00	5	0.65
Belgium	8	4.00	33	4.31
Denmark	11	5.50	43	5.61
Finland	7	3.50	51	6.66
France	22	11.00	274	35.77
Germany	88	44.00	188	24.54
Italy	4	2.00	2	0.26
The Netherlands	1	0.50	73	9.53
Sweden	7	3.50	73	9.53
Switzerland	40	20.00	24	3.13
<u>TOTAL</u>	<u>200</u>	<u>100</u>	<u>766</u>	<u>100</u>

II.

Distribution of Adopting and Local Accounting Standards Firms by Industry:

<u>Industry</u>	<u>Adopting firms</u>		<u>Local Standards firms</u>	
	<u>Number of firms</u>	<u>Percent</u>	<u>Number of firms</u>	<u>Percent</u>
Mining	7	3.50	44	5.74
Construction	46	23.00	164	21.41
Manufacturing	86	43.00	235	30.68
Utilities	21	10.50	33	4.31
Wholesale and Retail Trade	21	10.50	125	16.32
Finance, Insurance, and Real Estate	6	3.00	81	10.57
Services	13	6.50	84	10.97
<u>TOTAL</u>	<u>200</u>	<u>100</u>	<u>766</u>	<u>100</u>