Business and Management Aspects of International Accounting Standardization

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Abstract

The goal of this study is to describe and summarize how the accounting standards can promote managerial decisions and influence business environment. 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 of certain countries. The results of applied regression model support that the greater demand for more informative and conservative accounting earnings due to performance evaluations at more widely held by businesses stimulating to adopt international accounting standards. Businesses with lower labour productivity compared to their industry peers have greater incentives to follow accounting standardization.

Keywords: Management in enterprises, Business environment, Accounting standards, Comparable research, Hungary

1. Introduction

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.

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 my 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

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, using the accounting standards consistently by firms we will find that they are changeable, because they are 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 accounting rules to be applied around the world (Whittington, 2008).

International harmonization of accounting standards is an important topic in this globalising economy, because 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. 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, organizations the need to coordinate different investment decisions has increased. A suitable accounting information system can help multinational businesses accomplish their managerial functions on a global basis. Standard setters, company managers and researchers alike are interested in the evolution of global standards.

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 are growing the costs of equities and are less accurate the economical and financial forecasts. This requires the development and review of the national accounting rules, the separate validation of the tax and accounting regulation, the repeal of the subordinate role of accounting, issuing international standards with the help of practical and theoretical accounting experts.

2. Previous related literature

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, 2008). The accounting system is a complementary component of the country's overall institutional system (Ball et al., 2006) and is also determined by businesses' incentives for financial reporting. Li and Meeks (2006) provide the first investigation of the legal system's effect on a country's financial system.

The financial reporting quality include the tax system (Shleifer and Vishny,. 2003) ownership structure (Easton, 2006; Ball and Lakshmann, 2005), the political system (Leuz et al., 2006), capital structure (Daske et al., 2006) and capital market development (Botsari and Meeks, 2008). Therefore, controlling for these institutional and firm-level factors becomes an important task in the empirical research design too.

One study (Meeks and Swamm, 2009) characterises of accounting amounts for businesses that adopted international 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. They found, that international standards 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 international standards.

Another study (Jermakowicz et al., 2007) found that first time mandatory adopters experience statistically significant increases in market liquidity and value after international standards reporting becomes mandatory. The effects were found to range in magnitude from 3 % to 6 % for market liquidity and from 2 % to 4 % for businesses by market capitalization to the value of its assets by their replacement value.

3. The role of management accounting in business environment

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.

Europe is rich in well-tested, highly advanced management accounting and controlling concepts. However, each management accounting tradition has thus far been developed and applied more or less in a specific national context. A huge potential to shape the management accounting and controlling practice globally remains unused and unexploited. I therefore propose a cooperation initiative that addresses all European controlling and management accounting associations, as far as possible with the support of the European Union. Its mission:

- to bring the major players in the controlling and management accounting scene in Europe together for such a pan-European initiative,

- to establish one European standard for management accounting and controlling by combing the strengths of the different approaches,

- to take the lead in defining international management accounting standards,

- to create enough momentum to attract non-European parties to join the initiative in a second step the development of a new proven 'best practice' in creating controlling, management accounting and analytical data to support managerial decision making based on an international management accounting performance concept is at best still in its early stage. What I completely lack so far is analytical and management accounting concepts based on the international performance-philosophy supporting by management in detailed day-to-day decision making.

My research recorded the following notes according to international management accounting standards:

- One aspect is that businesses span today – also at midsized companies – across many countries and are increasingly international. Therefore companies need controlling and management accounting concepts standardized across their local operations in order to create a common internal global 'language' in decision making and performance management. As a consequence, the development of new management accounting best practices and concepts has to move to an international level.

- The second aspect is that traditional management accounting concepts are falling short to support today's managerial decisions and to support the valuation of many of today's corporate assets. The main reason for this is that the foundation of these management accounting concepts and instruments (focusing mainly on cost accounting) have been created 80–100 years ago in an era, were the main value creation process of most companies was mass-manufacturing. For the value creation activities of today – in R&D, marketing, strategy management etc., we still lack concepts and instruments in management accounting and decision support that apply the same rigor and strength like the traditional product costing and margin accounting concepts that supported well for decades the mass-manufacturing model. We have to move to the next level in management accounting and controlling.

- The third aspect is that management accounting cannot be standardized in the same way like financial accounting. Nevertheless companies do not want to 'reinvent the wheel' all the time, when they have to find new solutions in management accounting and controlling. What is needed is a set of agreed 'best practice standards' for how to conceive management accounting and decision support systems in a specific managerial context and for supporting specific managerial decisions.

4. Methodology

The purpose of this study was the measuring, valuing and analyzing the international methods and their effects on the business decisions. This survey contains information on how local, national accounting rules (GAAP) differs from international standards 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 international standards adopting and 260 local (Hungarian) rules firms. It is included all local standards enterprises in this analysis. An alternative approach it to create a matched sample of local standards businesses based on criteria such as year and industry. It is chosen to incorporate all local standards 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 international standards and those following national accounting rules. For the international standards used enterprises the adoption year is treated as event year 0

The adoption decision models are expanded relying Nobes (2008) 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 after the prior literature (Wu and Zhang, 2009):

$$\begin{aligned} Prob\,[Adopt = 1] = Logit\,(a_0 &+ a_1\ Close\_Held_0 + a_2\ Labor\_Prod_{-1} + a_3\ RET_{-1} \\ &+ a_4\ ROA_{-1} + a_5 Size_{-1} + a_6 Lev_{-1} + a_7\ Growth_{-1} \\ &+ a_8 Foreign\_Sales_{-1}\ ). \end{aligned}$$

<u>*Where*</u>:

Close_Held : Percentage of closely held shares at the end of event year 0 (event year *t* for the management turnover and employee layoffs analyses)

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

	productivity in the same industry group
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.

Hypothesis predicted that the businesses with lower labour productivity face a greater need for informative measures of firm performance to facilitate internal performance evaluation, therefore a higher probability of international standards adoption. It was expected that the coefficients on the percentage of closely held shares ($Close\_Held_0$) and labour productivity (industry-adjusted sales per employee, $Labor\_Prod_{-1}$) variables to be negative, because prior researches (e.g. Meeks and Meeks, 2002) are established that these variables associated with disclosure incentives have predictive power for the adoption decision. It is included that 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 expected that the coefficients on firm size, leverage, growth to be positive. The regression results are reported in Table 1, if international standards are adopted by businesses.

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, -0.00435, 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 0.61 percent or 5 percent of unconditional adoption probability of 20 percent (65/325). The coefficient on $Labor\_Prod_{-1}$ is -0.00004 negative as expected and significant as the 0.05 level. The marginal effect indicates that a one standard deviation increase in labour productivity reduces the likelihood of adoption by 1.05 percent.

5. Empirical results

The results of applied regression model support that the greater demand for more informative and conservative accounting earnings due to performance evaluations at more widely held by businesses stimulating to adopt international accounting standards.

The businesses with lower labour productivity compared to their industry peers have greater incentives to adopt international accounting standards.

The control variables are suggested that larger businesses with higher leverage and more substantial foreign sales are more likely adopt international standards.

Analyzing the changes of labour productivity at the adopting businesses the tests did not show a significant decreasing in the productivity over the last 5 years (2005 – 2009). 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.

6. Conclusion

The present impetus for global accounting information system follows the accelerating integration of the word economy. 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 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 management accountants alike have significant roles to play in this exciting future.

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Table 1. Results of logistic analysis

Analysis	**Estimate**	**Standard Error**	**Marginal Effects***
$Close\_Held_o$	-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%

,* 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.