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The Classification and Harmonization of Accounting Systems. An empirical study of European Union Countries that are not part of the Euro-zone.

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ABSTRACT : *Classification is the fundamental key to understand and analyze why and how the national accounting systems are different. It also gives us the opportunity to analyze whether these systems are converging or diverging. The main purpose of classification is to group the countries according to their distinctive characteristics of their financial accounting systems. Classifications are a way of viewing the world. From the other hand international harmonization of accounting has been defined as the attempt to bring together different systems. It is the process of blending and combining various practices into an orderly structure, which produces a synergistic result. The harmonization of financial accounting and reporting standards is seen as a mean of facilitating the globalization of capital markets. In this paper we are trying to analyze the accounting systems of countries that belong to the European Union but they are not part of the Euro-zone. The results indicate that the accounting systems of these countries are facing many differences in the accounting practices. All these differences do exist and are causing problems for a wide variety of groups, organizations and individuals*

KEYWORDS: *Accounting Systems, Classification, Harmonization, Euro zone.*

I. INTRODUCTION

Accounting harmonization refers to the process of reducing differences in accounting systems between two or more countries using specific forms of intervention. Accounting harmonization has been addressed by its advocates as an effective means of facilitating cross-border economic activities and reducing the general costs of compliance with different accounting standards (Saudagaran et al. 1997). Harmonization works at different levels: concepts, principles, regulations, and practice. However, harmonization achieved at a level (such as regulations) does not necessarily imply harmonization at a different level (such as accounting practice) (Frost , 1994).

According to the definition of Nobes and Parker (2002), "harmonization is the process of increasing the comparability of accounting practices by reducing the degree of flexibility and choice between different solutions." On the other hand, Hoarau (1995) consider harmonization as a political process to reduce accounting practices between countries in order to increase comparability and competitiveness. Belkaoui (2012) argues that it is a big mistake to consider harmonization as a concept identical to total standardization. The same view is shared by Tay & Parker (1990) who stressed the need to separate the two concepts. In particular, they argue that harmonization in contrast to standardization implies reconciliation between opposing views. This is a more conciliatory and practical approach than standardization, especially when standardization requires that accounting practices followed by a country become obligatory for other countries as well. That is, we could say that harmonization is a way of achieving a better exchange of information so that they can be understood internationally. Through this definition it is easily understood that in different countries there are different standards to the extent that they are in harmony, i.e. there is no logical conflict between them. On the other hand, standardization means the existence of a standard or rule that is accepted by all countries.

II. LITERATURE REVIEW

Classification: We could better understand a nation's accounting by knowing the factors that influence the development. Accounting clearly differs around the world and in other words, these factors make us observing the differences and the similarities between the accounting systems in different countries. Due to the fact that accounting respond to its environment, different cultural, economic, legal, and political environments produce different accounting systems, and similar environments produce similar systems. This leads us to classification. Classification is fundamental to understand and analyze why and how national accounting systems differ.

It also gives us the opportunity to analyze whether these systems are converging or diverging. The goal of classification is to group countries according to the distinctive characteristics of their financial accounting systems. Classifications reveal fundamental structures that group members have in common and that distinguish the various groups from each other. By identifying similarities and differences, we can better understand the accounting systems. Classifications are a way of viewing the world. International accounting classification work has been done in two ways: judgmental classifications and empirically classifications. Although the methods of analysis for the two approaches are different, their results are generally in agreement. Mueller in 1967 made the initial work on classification. Mueller's classification scheme was widely used by national institutes of accountants, international organizations and multinational professional accounting service firms. Later, the American Accounting Association's 1975-76 and the Committee on International Accounting Operations and Education classified the accounting systems of the world into five separate "Zones of Influence." They based their conclusions on historical, cultural and socioeconomic sources that have influenced accounting principles of financial measurement and reporting in different countries and regions. After Mueller, Nobes, based on these earlier studies, showed that classification not only indicates which countries are in different categories, but also how close or distant these categories are to one another. Further, Gray developed a different judgmental classification scheme based on his work linking accounting and culture.

Another system of classification is to analyze accounting and reporting standards and practices actually in use. Frank Werner (1979) showed that financial accounting and environmental factors are related, and he supported that accounting similarities can be expected among countries with similar environments. A few years later a new study by Nair and Frank Werner (1981) extended the Frank's study in two ways. The conclusion from this study is that measurement practices should be distinguished from disclosure and that accounting measurement seems to be more stable than disclosure. According to the literacy, we can say that classification has practical benefits. Due to the coexistence of certain countries in a common group, these countries acquire common characteristics of reaction. The differences among groups are barriers to the regional and worldwide harmonization efforts. It is easy to succeed, if the groups involved (such as the International Accounting Standards Board at international level and the European Union at regional level) understand the differences that they should overcome. Many times, developing countries can not develop their own accounting standards, so it is a frequent phenomenon to copy existing standards as China and other countries in Eastern Europe are doing now. The communication problems are very often. The companies face users (internal and external) who are unfamiliar with every company's accounting standards. All the companies need to speak the same language.

It is known that every nation's accounting standards and practices is a result of economic, historical, institutional and cultural factors and that is the "variety" among countries. It is important to mention the following eight factors that have a significant influence on accounting development. The first seven are economic, socio-historical and institutional in nature. Recently, the relationship between culture (the eighth item) and accounting development has begun to be explored. In countries with strong equity markets such as the United States and United Kingdom, accounting focuses on firms' profitability. The companies need to meet the shareholders' interest. Japan and Switzerland are examples on the other side. In these countries, the credit-based system (bank) is the dominant source of finance and accounting focuses on creditor protection through conservative accounting measurements. The financial institutions have direct access to any information they want so extensive public disclosures are not considered necessary (Bellanca et. al. 2015).

The legal system determines how individuals and institutions have an effect on each other. The Western world has two basic orientations: legalistic (code or civil law) and non-legalistic (common or case law). Code law derives mainly from Roman law and the Code Napoleon. In code law countries, laws are a set of requirements and procedures, and codification of accounting standards and procedures are natural. On the other hand, the common law develops on a case-by-case basis. Common law derives from English case law. Of course, statute law does exist, but it tends to be less detailed and more flexible than in a code law system. This encourages experimentation and permits the exercise of judgment. In most common law countries, accounting rules are established by private sector professional organizations. This allows them to be more adaptive and innovative.

Taxation is another critical issue. In many countries, tax legislation effectively determines accounting standards because companies must record revenues and expenses for tax purposes (Germany, Sweden). In other countries (Netherlands), financial and tax accounting are separate but often tax legislation require the application of certain accounting principles.

It is known that accounting ideas and technologies are transferred through conquest, commerce and similar forces and the "copying" is a motivation for the harmonization of accounting. Double-entry book keeping, which originated in Italy in the 1400s, gradually spread across Europe with other ideas of the Renaissance. British colonialism exported accountants and accounting concepts throughout the empire. Many developing economies use an accounting system that was developed elsewhere, either because it was imposed on them (for example, India) or by their own choice (for example, countries of Eastern Europe are modeling their accounting systems after European Union (EU) regulations). Another factor that affects the accounting development is the inflation. Inflation distorts historical cost accounting and affects the prices. Israel, Mexico and certain countries of South America use general price-level accounting because of their experiences with hyperinflation. In the late 1970s, in response to unusually high rates of inflation, both the United States and United Kingdom experimented with reporting the effects of changing prices (Nobes, C., 2011). The economic growth of a country influences the structure of the company and the way that functions. This factor affects all the types of business transactions and determines which ones are most prevalent. All the enterprises are adapted in the prevailing conditions because the most important issue they face is the new accounting challenges.

The level of education is the last of the seven parameters that affect the accounting development and belong in the sphere of economic, socio-historical and institutional factors. There are so many terms in the economic scene that is impossible to comprehend them easily. It has no mean if highly sophisticated accounting standards and practices are misunderstood and misused. That is the magic. People must understand these terms in order to use them correctly and provide the accounting principles. The only way to do so is a high educational level.The new factor "culture" means the values and attitudes shared by a society. Cultural variables underlie nations' institutional arrangements. According to Hofstede, culture is defined as collective programming of the mind; it manifests itself not only in values, but in more superficial ways: in symbols, heroes, and rituals (Hofstede, 2001). With the help of a model, cultural differences and their consequences between nations, societies, and regions can be described in detail. There are four national cultural dimensions or societal values, the individualism, the power distance, the uncertainty avoidance and the masculinity. His analysis is based on data from employees of a large U.S. multinational corporation operating in forty different countries. He said that "…individualism (versus collectivism) is a preference for a loosely knit social fabric over an interdependent, tightly knit fabric. Power distance is the extent to which hierarchy and an unequal distribution of power in institutions and organizations are accepted. Uncertainty avoidance is the degree to which society is uncomfortable with ambiguity and an uncertain future. Masculinity (versus femininity) is the extent to which gender roles are differentiated and performance and visible achievement (traditional masculine values) are emphasized over relationships and caring (traditional feminine values)…".

In this point, it is considered to report widely the theories of Mueller (1967, 1968), Nobes (1983) and Gray (1988). The macroeconomic pattern, the microeconomic pattern, the independent discipline approach and the uniform accounting approach were first proposed by Mueller. Mueller's (1967) study identified four distinct patterns of contemporary accounting development. He believed that many factors, such as the stage of economic development, the stage of business complexity, the shades of political persuasion, and reliance on particular systems of law, would lead to the development of different schemes of contemporary accounting. The macroeconomic pattern is based on three propositions, the business enterprise is the basic component in the national economy, the business enterprise succeed its goals best through close coordination of its activities with national economic policies and public interest is served best if business enterprise accounting is closely linked to national economic policies (Sweden). Under the microeconomic approach, the individual firms are the core of business activities, the main aim of the firm is to survive, firm's best strategy for survival is economic optimization and accounting derives its concepts and applications from economic analysis. The central accounting concept here is that the accounting process must hold the amount invested in the firm constant in real terms (Netherlands).

Business operates independently and produces its own concepts and methods from experience and practice. Accounting is viewing here as a service function that derives its concepts and principles from the business process it serves, not from a discipline such as economics (United Kingdom, United States). Finally, the uniform accounting approach maintains that accounting is a tool for administrative control. This approach is used in countries with strong governmental involvement in economic planning (France). Nobes continued the study above adding in his classification fourteen essentially ''Eurocentric'' capitalist countries. His study was dominated by the structural constraints of the priorities of capital.

It was necessary for him to report an acceptance of the social, political and economic arrangements, but also the belief that all self- interested economic transactions must rely on some underlying bond to remain coherent. Supported in previous studies, Gray (1988) suggested four accounting value dimensions that affect the financial reporting practices. He believed that statutory control, uniformity, conservatism and secrecy are the elements in a high-power distance society. These societies are hard, there is no trust between people, there exist null information of public and an imposition of laws and codes is accepted. On the other hand, there are the professionalism, the flexibility, the optimism and the transparency. In this case, people are more concern for equal rights, there is trust, and they are not scared for the future and business information move on a need-to-know basis.

On the basis of data gathered during the 1988–1992 period from 86 samples drawn from 41 cultural groups in 38 nations, Schwartz (1994) and Schwartz and Bardi (1997) divided national cultures into seven value types. Conservatism, autonomy, hierarchy, mastery, egalitarian commitment and harmony are the main ideas in Schwartz’s study. Conservatism means the emphasis on the status quo and prohibits actions that might disrupt the traditional order. Autonomy means the emphasis on the person viewed as an autonomous entity. Hierarchy means the emphasis on how important is the hierarchical role. Mastery is the emphasis on active mastery of the social environment through self-assertion. Egalitarian commitment is how people can control selfish interests and harmony emphasizes on the unity with the nature. These culture-level value types are condensed by Schwartz into two broad dimensions: autonomy versus conservatism and egalitarian commitment and harmony versus hierarchy and mastery.

Harmonization : The big growth of international market leads us to wonder why do we need harmonization of International Accounting Standards, what are the advantages and what are the barriers that hinder harmonization? Although accounting may be the "language of business”, a common language has never been necessary. This, however, is no longer true. We now face a global economy and this affect the entire business world. Today's global corporation makes the production and distribution facilities separate widely. So, multinational corporations must prepare multiple reports for different nations they do business in. Prices, interest rates and currency exchange values have become internationally linked. Harmonization is necessary because standard national financial statements are useless. There is a need for harmonization for accounting standards in order to help the foreign investor to understand the financial statements of the foreign companies whose shares they might want to buy. After all, financial information is a form of a language, so that information could be comparable. The new factors of the global economy lead to the adoption of International Accounting Standards (IASs) and the harmonization of the accounting practices (Beck et. al., 2017).

Many writers underline the advantages of harmonization. According to Turner (1983) the greatest benefit that would flow from harmonization would be the comparability of international financial information. The comparability would eliminate the current misunderstandings about the reliability of foreign financial statements and would remove one of the most important obstacles in the services of international investment. Choi, Frost and Meek (1999) said that harmonization would save time and money that is currently spent to consolidate divergent financial information when more than one set of reports is required to comply with the different national laws or practice. They also added that harmonization improves the tendency for accounting standards throughout the world to be raised to the highest possible level and to be consistent with local economic, legal and social conditions. Nobes and Parker (2002) believed that it would be beneficial to countries which do not have standards of accounting and it would also help in raising foreign capital as investors, financial analysts and foreign lenders will be able to understand the financial statements of foreign companies. Samuels and Piper (1985) supported that on the line of harmonization firms and users would be able to compare the investment opportunities which will help them to make the right investment decision. As taxes exist on the total global income of an organization, it would be helpful to the national tax authorities around the world if they computed them on similar accounting principles and practices. All the above is a small number of opinions around the advantages of harmonization and are the prevailing opinions. Always when advantages exist, we also have and disadvantages.

The most fundamental obstacles to harmonization are the present of differences between the accounting practices of different countries, the lack of strong professional accountancy bodies in some countries and the differences in the political and economic systems (Nobes and Parker 2002). Many writers mentioned that if accounting measurement rules were the only difference among countries, then straightforward translations would be sufficient to enable reports to be understood and interpreted.

However, countries also raise substantial economic and cultural differences that preclude simple interpretations, even when the figures are generated use the same accounting principles. The degree to which the government is involved also varies from country to country. Whereas professional organizations set the standards in Britain, for example, the government assumes this responsibility in France. Another barrier that the governments of different countries will have to face is the coordination of their accounting policies with policies prevailing in other countries in order to minimize negative externalities and to maximize positive externalities. There are many barriers to harmonization as well. Users have different needs in different nations (debtor vs. creditor, countries that have very active stock markets and those where banks primarily accumulate and invest capital) (Wyatt 1997). The existence of these barriers enforces the belief that the public does not desire the adoption. However there are a number of benefits as well which will come with the harmonization of international accounting standards.

Companies are preparing financial statements for its users who are interested on the company. But it is not the only reason. It is so hard for a company, any time making an investment in a country, to deal with a new set of accounting standards. A uniform set of accounting standards, adopted from all the countries, provide efficiency gains both internally and externally (Epstein and Mirza, 2001). So, the writers will best serve the client if harmonized principles and practices are followed. A similar internal reporting system gives the chance of better comparisons, less confusion and mistakes between the parts of the company. Cost savings can be achieved, because the preparation of financial statements will be easier for companies. With Accounting Standards, the credibility of the externally reporting could be raised. All the reported figures would be shown in the same way. The access to main financial markets will become easier for companies and the capital would be appeared simpler for them. At the other hand, there are users (employees, investors, banks, and owner). Harmonization brings a lot of advantages.

Investors, banks or owners are interested in obtaining information, which enables them to take investment decisions. Financial statement based on harmonized principles would make easier the comparison between companies because similar transactions take place in the same way everywhere in the world. In other words, similar accounting practices lead to a better comparability between companies. It is a major theme, the fact of better understanding the reports because the risk is lower and the selections of investments is more efficient. Choi et al. argue that "financial statement users have difficulty in interpreting information produced under non-domestic accounting systems. They claim that harmonization will make it more likely that users will interpret the information correctly, and thus make better decisions based on that information" (Choi et al., 2002). For the employees, we can claim harmonized accounting standards are important because they can better understand the development of the company they work in and operate its functions efficiently.

Harmonization is a movement away from total diversity of practice. According to Fredrick Choi (1999), harmonization is a process of increasing the compatibility of accounting practices by setting limits on how much they can vary. From this definition, harmonization of standards will minimize logical conflicts and improve the comparability of financial information from different countries. Harmonization is flexible and open. R.D. Nair and Werner G. Frank, in their article "The Harmonization of International Accounting Standards, 1973-1979", wrote that in the 1970s, serious attempts were made to harmonize international accounting practices. This effort was important because the growth of international trade and of multinational corporations necessitated the comparison of accounting data across national boundaries. From all the above, it is clear that international harmonization of accounting standards is vital to promote the international capital market and it is also necessary to overcome the difficulties. In spite of differences in international financial reporting, harmonization of the accounting practices was used in the preparation and presentation of financial information.

The difference between harmonization and standardization : International accounting harmonization generates interest among accounting practitioners, academicians, investors, and other users of financial reports. Many organizations proposed the accordance of financial reporting. In this point, it is essential to make clear the concepts of harmonization and standardization and whether the target is harmonization or standardization (Sforza, V. and Cimini, R., 2017). Both 'harmonization' and 'standardization' are used in accounting practice and in the literature. Harmonization is a movement away from total diversity of practice and standardization is a movement toward uniformity. There is no real difference between them, perhaps, in the degree of harmonization they involve. In each case, they refer to the efforts required to ensure that transactions and events are accounted in the same way wherever they took place or were reported. "Standardization" implies uniform standards in all the countries involved.

"Standardization" is also a process, a movement towards uniformity, which is also a state (Tay and Parker, 1990; Nobes and Parker, 2000). "Harmonization" implies a reconciliation of different points of view, and permits different requirements in individual countries to be reported in a uniform way provided that there is no logical conflict (Canibano and Mora, 2000). Wolk et al. describe harmonization of Accounting Standards as "the degree of co-ordination or similarity among the various sets of national Accounting Standards and methods and formats of financial reporting" (Meek and Saudagaran in Wolk et al., 2001). Roberts et al. give a similar definition, who describes harmonization as a process "which accounting moves away from total diversity of practice" (Roberts et al., 1998). Hence, international accounting harmonization can be defined as "the process of bringing international Accounting Standards into some sort of agreement so that the financial statements from different countries are prepared according to a common set of principles of measurement and disclosure" (Haskins et al. 1996). From all the above definitions, it is clear that harmonization of standards will minimize logical conflicts and improve the comparability of financial information from different countries. The final end is a standardized situation, in which homogeneity and uniformity exist (Bellanca et. al. 2015).

COMPARISON OF IFRS WITH NATIONAL ACCOUNTING SYSTEMS : This section presents the significant differences in accounting principles between IFRSs and the national Accounting Systems of countries that belong to the European Union but not in Euro zone.

Czech Republic : The Czech accounting is based mainly on the accounting law, the Accounting Plans and accounting procedures of the Ministry of Finance. There are some differences between Czech standards and international accounting standards which are mentioned below. In Czech Republic accounting system the foreign exchange earnings are generally not recognized as income until the payment and the profits and losses of foreign business entities resulting from the conversion of the financial statements into the corresponding currency are recognized in the income. Some research costs can be capitalized and Goodwill is determined on the net book value instead of the fair value. Regarding goodwill is not depreciated, but is treated as an expense. Moreover, provisions can be made where there is no balance sheet obligation and the deferred taxation should be calculated only on the basis of certain time differences instead of all temporary differences. In addition stock trading, available-for-sale and derivative financial products are not recognized at fair value and stock trading and liabilities from derivative financial products are not recognized in the fair value. Finally the identification of extraordinary results is wider and the acquisition costs are generally not included in the cost of the investment.

Denmark : Denmark's financial reporting requirements are mainly based on the business Accounting law and standards issued by the Danish Accounting Standards Committee. Also the accounting standards are mandatory for listed companies. The main differences between Danish standards and IFRS are as follows. The differences of the Danish accounting system and the IFRS are as following. First of all in acquisitions, the acquired identifiable assets and liabilities do not need to be calculated on the basis of fair value, and the business acquisitions can be extended. Special purpose entities are joined when at least one share is owned. In addition in Danish accounting system goodwill in the acquisition and consolidation process can be immediately deducted from the share capital. An important point is also that in acquisitions, the restatement of net assets to the actual value can be limited to the difference between cost price and net book value. Therefore, the creation or increase of negative goodwill is avoided. Brokerage transactions, available-for-sale and derivative financial products are not recognized at fair value and also brokerage transactions and liabilities from derivative financial products are not recognized in the fair value. Finally hedge accounting is allowed to a greater extent.

Hungary : The Hungarian accounting is based on an accounting law of 2000. The main differences between Hungarian accounting regulations and IFRS are described below. The acquisition day of the subsidiary company is generally considered the end of the acquisition year and also on acquisition, a real valuation exercise is not mandatory and cannot lead to negative goodwill. Minority entries are not disclosed separately in the income statement and as associated investments are classified the investments with an acquisition rate of 25% or more. In addition undetermined earnings on foreign currency balances are disregarded unless they are determined by the balance sheet date and specific start-up and restructuring costs are capitalized. One other difference is that impairment tests are not required for most of the assets and they are reported in the net selling price instead of the recoverable amount. The depreciation of the revalued assets is still calculated on the basis of the cost of acquisition and leases are generally not recognized as financial leases. Stock trading, available-for-sale and derivative financial products are not recognized at fair value and also stock trading transactions and liabilities from derivative financial products are not recognized in the fair value.

Finally provisions are recognized where there is an obligation in the balance sheet, the definition of extraordinary results is broader and Cash flow statements are complementary notes.

Sweden : Swedish accounting system is based on the annual Accounts Law, which includes the EU directives and accounting standards of the Accounting Board. In rare cases, a model of the Accounting Board can be diverted if the diversion has been revealed and is sufficiently justified. Full compliance to the standards of the Accounting Board is not required for non-listed companies, although the adoption of standards is becoming increasingly common. The standards of the Swedish accounting system and IFRS differ in the following accounting fields. Stock trading, available-for-sale and derivative financial products are not recognized at fair value and also stock trading transactions and liabilities from derivative financial products are not recognized in the fair value. Impairment tests are based on the existence of permanent decline of value and Hedge accounting is allowed to a greater extent. The pension calculations generally do not use the pre-planned credit method, the current interest rates or the estimates of future salary levels, but a monetary obligation of an increasing advantage based on the current salary level. The accounting system states that in the context of business acquisitions, a deferred tax obligation can be discounted and predictions can be created more extensively. Finally the creation of predictions can be done even when all the criteria are not met and do not need to be discounted.

III. CONCLUSION

Classification is fundamental to understand and analyze why and how national accounting systems differ. It also gives us the opportunity to analyze whether these systems are converging or diverging. The goal of classification is to group countries according to the distinctive characteristics of their financial accounting systems. Classifications reveal fundamental structures that group members have in common and that distinguish the various groups from each other. By identifying similarities and differences, we can better understand the accounting systems. Classifications are a way of viewing the world. Efforts have been made by a number of organizations to reduce the differences between accounting systems. The coordination of efforts, to compile an international set of standards, was formalized in 1973 by the International Accounting Standards Committee (IASC). The harmonization is concerned with reducing the diversity that exists between accounting practices in order to improve the comparability of financial reports prepared by companies from different countries. Harmonization occurs as more companies choose to prepare financial statements using the same accounting practice. The terms increased comparability and harmonization will be used interchangeably. In the literacy many authors stated that there are many international differences among the national accounting systems of each country and there are harmful effects on the comparability of financial reports. These differences can be observed in issues such as consolidation in goodwill, deferred taxes, long-term leases, inventories, inflation, total profits and losses. Many researchers have listed a number of factors that are considered to be the possible causes of these differences in the accounting systems of different countries. The most important possible causes are culture, legal systems, sources of finance and taxation. Our analysis indicates that differences in accounting practices in countries among the Europe union but not in Euro zone exist and cause problems for a wide variety of groups, organizations and individuals. All the countries must try to harmonize their accounting systems to overcome the problems that occur from the differences.

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