

## **The Influence of Religion on the Globalization of Accounting Standards**

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Considerable effort has been expended to create globally uniform accounting standards. It is believed that the harmonization of accounting standards will create more efficient and more closely interconnected financial markets, improve the allocation of resources, and reduce transaction costs. Currently, the two leading contenders in the global competition for the authority to define accounting standards are U.S. Generally Accepted Accounting Principles (GAAP) and International Accounting Standards (IAS). The International Accounting Standards Committee (IASC) was founded in 1973 in order to set IAS and encourage their global acceptance. A common criticism of the early IAS was that there was too much flexibility in the standards and not enough in the way of required disclosures (Imhoff, 1999). Efforts were taken to minimize the differences between IAS and U.S. GAAP and by the late 1990's supporters of IAS asserted that the IAS were of comparable quality and any remaining differences were minor (Leuz, 2003). In 2002 the IASB and Financial Accounting Standards Board (FASB) agreed to jointly undertake a convergence project with the objective of eliminating a variety of the differences that exist between IAS and U.S. GAAP. As recently as September 2004, the Chief Accountant of the U.S. Securities and Exchange Commission stated that:

The FASB and IASB support moving toward a single conceptual framework that would be used by both Boards. The work of these two Boards, and other national standards setters involved in the IASB process, is an important part of building and maintaining an effective global financial reporting infrastructure. I also support global convergence. It's in the best interest of investors. (Nicolaisen, 2004, p.5)

Significantly, beginning in January 2005, most public companies operating within the European Union will be required to use IAS and will lose the option of using U.S. GAAP for listing purposes. Therefore, U.S. companies that have a subsidiary in a European Country will be required to report according to IAS (Gannon and Ashwal, 2004).

The differences between IAS and U.S. GAAP, although fewer than in the past, are still numerous. For example, a newsletter published by Deloitte Touche Tohmatsu summarizes key differences that currently exist between the two sets of standards. The June, 2004 document summarizes over 100 differences. The following table highlights just a select few of the differences which at the moment are not scheduled to be addressed by the two Boards:

IAS 1: Extraordinary items
IAS: Prohibited
US: Permitted but restricted to infrequent and unusual events

IAS 2: Method for determining inventory cost
IAS: LIFO is prohibited
US: LIFO is permitted

IAS 2: Reversal of inventory write-downs
IAS: Required
US: Prohibited

IAS 7: Classification of interest received and paid in the cash flow statement
IAS: May be classified as an operating, investing, or financing activity
US: Must be classified as an operating activity

IAS 11: Construction contracts when the percentage of completion cannot be determined
IAS: Cost recovery method
US:: Completed contract method

IAS 12: Classification of deferred tax assets and liabilities
IAS: Always non-current
US: Classification is split between the current and non-current components based on the classification of the underlying asset or liability

IAS 17: Recognition of a gain on a sale and leaseback transaction where the leaseback is an operating lease
IAS: The gain is recognized immediately
US: The gain is amortized over the lease term

IAS 19: Recognition of past service costs related to benefits that have vested
IAS: Recognized immediately
US: Amortized over the remaining service period or life expectancy

IAS 38: Development costs
IAS: Capitalize, if certain criteria are met
US: Expense

Although numerous differences remain to be addressed, recent research seems to indicate that the significance of the differences is minimal. Leuz (2003) studied firms trading in Germany's New Market and found that "the choice between IAS and US GAAP appears to be of little consequence for information asymmetry and market liquidity. These findings do not support widespread claims that U.S. GAAP produce financial statements of higher informational quality than IAS" (p. 446).

There is concern that the considerable efforts focused on the harmonization of IAS and U.S. GAAP overlook some very important international differences. Hoarau (1995) suggests that international accounting harmonization is "predominantly harmonization with the Anglo-Saxon accounting model; it thus conflicts with the economic, social and cultural environment of other accounting systems" (p. 218). Hoarau notes that the growing influence of IAS needs to be viewed in relation to the far-reaching influence of U.S. GAAP. For, although IAS are more limited in scope and detail than similar U.S. GAAP, IAS still progress from the same concept of accountancy – that the primary objective of financial information is to provide useful information for decision making by investors. An investor-centered view of financial information makes sense in a country where the vast majority of its economic activity is conducted through

its stock exchanges. This investor-centered view of accounting affects the development of accounting principles and the nature of the financial information published. This view of accounting cannot be considered a “one-size-fits-all” solution to the need for financial information. In many European countries the protection of creditors is considered equally important as providing information for shareholders. For example, in Germany a main objective of accounting is the calculation of distributable income. The concern here is that the position of creditors and their claims should not be harmed by the disbursement of income to owners (Haller, 1995).

Research has criticized that accounting harmonization appears to be a one-way process. Harmonization seems to entail imposing Western accounting practices upon nations that are perceived to be less economically developed than in the West. Little attention is paid to the possibility that the accounting practices of diverse communities might give insights to alternative, theoretically defensible accounting practices (Hamid, Craig and Clarke, 1993). For the IASC to achieve accounting standard harmonization by generating accounting standards that primarily address the information needs of financial markets is to marginalize the financial information needs of other users (Hoarau, 1995). To be truly useful accounting standards must take into consideration the political, economic, social and cultural climate in which they will be employed, and these are factors which differ between nations.

The international accounting literature has given considerable attention to the influence of culture on accounting policy and practice (Hofstede, 1983; Gray, 1988). An objective of this attention has been to increase the understanding of how national differences may function as impediments to the international harmonization of

accounting standards. Differences in national cultures that have been considered to influence nations' methods of accounting include: the structure of the nation's accounting profession, the nature of indigenous business organizations, levels of public and private ownership, exchange rate stability, educational levels and policies, rate of economic growth, and the maturity of the legal system (Hamid et al., 1993). It is important to note that these cultural differences are all confined within national boundaries. Much less research has focused on the impact that cultural differences which transcend national boundaries have on the internationalization of accounting standards. Religion is one such cultural difference that transcends national boundaries and also has significant influence on the way business is conducted and recorded. The fact that the influence of religion on accounting is often ignored is not surprising considering how infrequently issues of faith and accounting are integrated. Society seems to assume that accounting standards are rigid and immune to significant interpretation. Chewing (1990), in his introduction to the chapter "A Theological Perspective on Accounting" in *Biblical Principles and Business: The Practice*, identifies this bias that many Christians bring to the discussion of faith and accounting by noting:

I cannot help wondering how many of those who read it will have ever thought that biblical principles could be applied to accounting.... The chapter also shows how God's revealed moral principles are so encompassing as to include something that seems, on the surface at least, to be so removed from theology. (p. 105)

In reality, accounting standards are not immune from religious influence. The fact that accounting harmonization seems focused primarily on bringing the world's

accounting systems into harmony with IAS (which are based on Western standards) also infers that Judaic-Christian traditions and values may influence accounting standards, but may not accommodate other religions, such as Islam. “Islamic law influences the conduct of businesses in a manner not accommodated automatically by Anglo-American accounting practice. And many Western accounting practices draw upon assumptions which conflict with the tenets of Islam” (Hamid et al., 1993, p. 134). The Islamic faith emphasizes the obligations of the individual to society and not the rights of the individual. In contrast to the focus being on the owners of an entity as in Western accounting systems, the focus in Islam is on the Unity of God. Given this focus, the entire community and the affected environment require accounting information that focuses on social accountability rather than the more narrowly focused personal accountability found in Western accounting information. The principle of full disclosure is interpreted to mean the disclosure of any information that should be made available to members of the community under the Muslim code of law (Baydoun and Willett, 2000).

In addition, unlike most Western traditions, fundamental business ethics flow from the practice of Islam, rather than from codes created and enforced by professional organizations. Muslim law, the Sharia, is incumbent upon every Muslim and provides the foundation for all Islamic financial institutions. Broadly defined, three Sharia rules set Islamic financial transactions apart from Western practice. First is a strict prohibition on involvement with industries considered sinful such as gambling, alcohol, and pig products. Second is a strict ban on *riba*, which is similar to interest. Third is the goal of avoiding *gharar*, which basically means excessive risk-taking and uncertainty (Gambling and Karim, 1986).

Islam’s prohibition of interest is based on God’s and the Prophet Muhammad’s warning against interest and debt. In the Quran it says “Oh you who believe! Devour not interest, doubled and multiplied. But fear God that you may really prosper.” And, “Those who devour interest will not stand except as stands one whom the evil one by his touch hath driven to madness.” Interest is forbidden because the opportunity for the borrower to invest money and earn a profit introduces an unacceptable speculative element into a business transaction. Muslims believe that it is unethical for the lender to have a guaranteed and fixed return while the lender experiences an uncertain and fluctuating return. On this basis, preferred stock is also unlawful. Islam’s prohibition of interest has significant implications for the harmonization of accounting standards since interest calculations are an integral component of many Western standards. Some of these standards include: pension benefits, amortization of long-term debt, debt restructuring, interest on receivables, asset impairment, and lease capitalization. Table 1 summarizes several key differences which exist between Western financial accounting systems and Islamic systems (Baydoun and Willett, 2000, p.82):

Table 1

<b>Characteristics</b>	<b>Western Financial Accounting System</b>	<b>Islamic Corporate Reports</b>
Philosophical Viewpoint	Economic Rationalism	Unity of God
Principles	Secular Individualistic Profit Maximization Survival of Fittest Process	Religious Communal Reasonable profit Equity Environment
Criteria	Based upon modern commercial law Limited Disclosure Personal Accountability	Based upon ethical law originating in the Quran Full Disclosure Public Accountability

It shouldn't be inferred that Islamic law is only in conflict with traditional Western accounting. It also requires additional, unique information from accounting systems that Western accounting currently does not provide. For example, Muslims are required to pay Zakah in accordance with the rules included in the Quran. Paying Zakah is a means of purification for Muslims, so it has more significant implications than just paying a tax. The basis for calculating the proper amount of Zakah is also quite complex. All money that is not used for a whole lunar year has a Zakah of 2.5 percent. Income from investments has a Zakah of 10 percent and salaries have 2.5 percent. Relevant to trade, Zakah is computed on both the net worth and on the net profit at 2.5 percent (Gambling and Karim, 1986). Zakah is based upon the excess of the wealth embodied in productive assets over a base amount. Current market value is set as the valuation basis to be used for Zakah calculation. Therefore, most of the asset information contained on traditional Western balance sheets is not in a form consistent with Islamic law. Islamic analysis also focuses on productive assets, whereas the traditional Western balance sheet includes provisions for deferred tax assets, goodwill on consolidation, capitalized expenses, etc. The information required for proper determination of the amount of Zakah places unique demands on accounting information systems, demands that cannot be met through standard Western accounting reporting.

It appears that religion is a significant cultural variable that exerts considerable influence both on how financial information is formed and how it is utilized. If international harmonization of accounting is to succeed it seems incumbent upon the IASC to allow nations to report their financial information in two formats. The first would fully comply with IAS and would prescribe a specific accounting treatment for

each area reported. The second format, if so-elected by a company, would allow companies to publish financial statements prepared according to national priorities and customs. Companies would also be required to prepare reconciliation schedules with the international standards. With this arrangement national standard setting bodies would still have a significant and visible role in the accounting standard setting process. Hopefully, this approach would also provide a mechanism for the exchange of information between national accounting standard setters and members of the IASC. Ultimately this approach would address the need for comparability of financial information while at the same time acknowledging that accounting information does not come in a “one-size-fits-all” format.

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