

## **CHAPTER 4 : CONSOLIDATION ACCOUNTING ISSUES**

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#### **4.1 INTRODUCTION**

In this Chapter the nature and diversity of consolidation accounting policies and practices are reviewed. The discussion commences with an outline of the historical development of consolidation accounting in Section 4.2. The origins of consolidation accounting are traced to the early period of the Twentieth Century in the United States and the United Kingdom. The spread of consolidation accounting practices to other countries is outlined with reference to the adoption of consolidation accounting in the ten countries that are the subject of this study. Alternative practices for recording and disclosing items in consolidated financial statements are discussed in Section 4.3. Surveys of consolidation accounting practice are reviewed and issues contributing towards diversity and non comparability of consolidated financial statements are identified in Section 4.4. Finally, in Section 4.5 various attempts that have been made to harmonise the practice of consolidation accounting internationally are reviewed.

Consolidation accounting is essentially the practice of combining the financial statements of two or more separate accounting entities into a single set of financial statements representing the combined financial position and performance of the entities. Consolidation is a fundamental accounting practice that influences the scope and content of corporate financial statements. The inclusion or exclusion of entities from the consolidated financial statements will, among other decisions, significantly affect the financial position and performance represented in the consolidated financial statements. The development of various alternative consolidation accounting practices and their adoption in different countries has contributed towards the non comparability of multinational corporation financial statements and the case for harmonisation of accounting practices internationally [Radebaugh and Gray (1993, pp.219-21)].

The theoretical framework for interpreting international accounting diversity, outlined in Chapters 2 and 3 above, indicates that variations in the practice of consolidation accounting between countries should be consistent with the underlying national cultural values of the country. Consolidation accounting practices cannot be directly observed because of the confidentiality surrounding the preparation of corporate financial statements. However, the outputs from the consolidation process can be observed in the form of disclosures contained in corporate annual reports. The information disclosed in consolidated financial statements can therefore be used to determine the extent to which consolidation accounting disclosures are associated with the national cultural values of the country from which the financial statements originated. In this way a test of the relationships predicted by Gray (1988) and Perera (1989) can be accomplished.

The identification of consolidation accounting issues in this Chapter enables items to be selected for inclusion in a consolidation disclosure index which is developed as

part of the research methods in Chapter 6. This index is used to measure the dependent variable, the extent of consolidation disclosure in corporate annual reports.

#### **4.2 THE HISTORICAL DEVELOPMENT OF CONSOLIDATION ACCOUNTING**

In this Section the historical development of consolidation accounting is outlined. The practice of consolidation accounting originated in the United States towards the end of the Nineteenth Century [Walker (1978a, p.120) and, Ma, Parker and Whittred (1991, p10)]. The idea of consolidation accounting was broadly discussed in the accounting literature of the time and during the first two decades of the Twentieth Century the practice of consolidation accounting gained widespread acceptance by American corporations. At this time disclosure laws and regulations concerning the preparation of financial statements were limited when compared with today. In this relatively unregulated environment consolidated financial statements prepared by parent entities became the primary form of financial disclosure. In most instances the parent entity did not publish separate financial statements. Thus, when financial accounting disclosure laws were introduced in the 1930s in the United States, parent entities were permitted to publish only consolidated financial statements.

The development of consolidation accounting in the United States can be contrasted with the situation in the United Kingdom where there was a much stronger set of corporate laws and regulations requiring individual corporations to prepare financial statements. When the practice of consolidation accounting was introduced during the 1910s and 1920s in the United Kingdom, consolidated financial statements were regarded as supplements to parent entity reports [Edwards and Webb (1984, p.56), Ma, Parker and Whittred (1991, p.11) and, Walker (1978a, p.77)]. The development of consolidation accounting in the United Kingdom commenced in the 1910s, approximately twenty years after its introduction in the United States. It did not gain

widespread acceptance until the late 1940s [Kitchen (1972), Edwards and Webb (1984) and, Bircher (1988, p.12)]. From this early period, consolidation accounting disclosure practices of parent entities diverged, with United Kingdom parent entities preparing both parent entity and consolidated financial statements while United States based parent entities predominantly prepared only consolidated financial statements. This diversity in consolidation accounting disclosure practice persists to the present with corporations following the United Kingdom tradition usually preparing both parent entity and consolidated financial statements and corporations following the United States tradition usually only preparing consolidated financial statements.

The transfer of accounting thought and practice from one country to another requires 'change agents' and 'recipients' [Parker (1979, p.125)]. The 'change agent' is responsible for communicating the new method or practice, participating with the recipient and adapting the innovation to the cultural patterns of the recipient. The 'recipient' must be responsive to new thought and practice, perceive benefits from adopting the change and be involved in both the planning and implementation stage of the change process. In transferring consolidation accounting practices around the globe Parker (1979, pp.125-6) identified six possible change agents:

1. The transfer of accountants to different countries.
2. The international accounting firm (which he considered to be the most effective change agent).
3. International organisations of accountants.
4. Governmental agencies.
5. Multinational companies.
6. Teachers and their textbooks.

The United States and the United Kingdom were the two countries where the practice of consolidation accounting first developed and gained acceptance during the early

decades of the Twentieth Century. From this beginning the practice of consolidation accounting was transmitted to other countries. For example, member countries of the British Commonwealth generally adopted United Kingdom company laws and financial disclosure regulations [Walton (1986)].

One illustration is Australia where the introduction of consolidation accounting and the associated development of legislative requirements has been documented [Whittred (1988, pp.6-12) and, Ma Parker and Whittred (1991, pp.14-16)]. The earliest instance of consolidation was reported to be in 1931, however widespread use of consolidation did not occur until 1950s [Whittred (1988, p.2 and p.17)]. When consolidated financial statements were prepared the predominant Australian practice involved the publication of consolidated financial statements as supplements to the parent entity financial statements in the tradition established by the United Kingdom. The Victorian Companies Act 1938 specified, in advance of the British legislation, that holding companies should prepare in addition to the parent company's accounts consolidated financial statements or alternatively prepare separate financial statements for each subsidiary [Whittred (1988, p.8)]. Thus, the tradition established in the United Kingdom was enshrined in the Victorian law and has remained a feature of Australian corporate disclosure to the present.

A second case illustrating the adoption of the provisions for consolidation accounting following the United Kingdom tradition was Malaysia. Malaysia became independent in 1957 and prior to this legislation concerning corporate reporting had followed the requirements of the Companies Ordinance of 1940 which was substantially the same as the 1929 British Companies legislation. Therefore, it did not require the preparation of consolidated financial statements. After independence Malaysia introduced a Companies Act in 1965 which was based on both the British Companies Act of 1948 and the Victorian Companies Act of 1961 [Walton (1986, p.355)]. In respect of the provisions for consolidation the Malaysian Act adopted the British

Companies Act of 1948 preference for consolidated accounts as supplements to the parent company's accounts as opposed to the Victorian Companies Act's free choice between consolidated accounts and separate disclosure of subsidiary company accounts [Walton (1986, p.355)].

Another case is Japan, where the adoption of consolidation accounting has been documented by McKinnon (1984 and 1986). The Ministry of Finance issued Ordinance No. 30 in October 1976 which required, among other things, all corporations that were subject to the Securities and Exchange Law to publish consolidated financial statements for accounting periods commencing on or after 1 April 1977 [McKinnon (1984, p.20)]. The key issue explored by McKinnon (1984) was the appropriateness of the Japanese adoption of consolidated financial reporting given its origins in the Anglo-American commercial environment and the significant differences in these conditions found in Japan. Among the conclusions McKinnon (1984, p.30) argued:

...the assumptions underlying consolidation practices in Anglo-American nations, including group association based primarily on share ownership criteria, the notion of control through direct or indirect majority share ownership, and the presence of a holding or ultimate parent company, are less appropriate to the corporate context of Japan.

If the corporate environment of Japan differed significantly from the Anglo-American equivalent such that it impaired the appropriateness of the underlying assumptions of consolidation accounting, then it could be expected that if other countries had corporate environments which also differed significantly from the Anglo-American environment, consolidation practices would likewise be inappropriate. Therefore, it is necessary to examine briefly the framework and underlying assumptions of consolidation accounting and to link these to consolidation disclosure practices.

When consolidation accounting practice commenced in the United States around the beginning of the Twentieth Century the commercial environment contained the following features: no taxes on incomes or distributions of corporations; generally holding companies held one hundred percent of the equity in their subsidiaries; holding companies and subsidiaries were treated as separate legal entities [Walker (1976, p.77)]. The current environment in the United States is characterised by different arrangements: taxes are levied by both Federal and State Governments on incomes and distributions of corporations in the United States; parent entities do not generally hold one hundred percent of the equity in subsidiaries; complex cross-equity holdings and other arrangements enable control to be exerted over subsidiaries; creditors are offered security by financial instruments that extend over the assets of more than one entity; many firms conduct their business via joint venture agreements and partnerships which may take a non-corporate form. In these current circumstances consolidated financial statements reflect different relationships to those prepared at the turn of the Century. These changes prompted Walker (1976, p.78) to argue:

These factors in themselves might suggest the need to reevaluate consolidated reporting. Moreover, the history of the use of consolidated statements indicates that contemporary rules governing this area of reporting are the outcome of confused ideas about the function of consolidated accounts. If the rules are confused, it follows that in some respects the product of using those rules will be a confused representation. And if those who prepare consolidated accounts are confused about what the statements represent, it seems likely that those who use consolidated statements may misunderstand the significance of consolidated data.

Not only has the commercial environment changed within the Anglo-American countries from that which existed when consolidated statements were first introduced, but also the use of consolidated financial statements has extended into countries with significantly different commercial and cultural environments from those of Anglo-American nations. McKinnon (1984) demonstrated that in the case of Japan both the

commercial and cultural environment contributed to the inappropriateness of Anglo-American principles of consolidation. Underlying assumptions in Anglo-American consolidation practice concern:

1. The existence of an ultimate parent entity.
2. The ability of this entity to exercise control over other entities, primarily by equity investment.
3. The recognition of the individuality of corporate entities within the group.
4. The need to report on the parent entity and controlled entities as if the group were a single entity.
5. The existence of a group of financial statement users who would be interested in this information.

In the case of Japan each of these assumptions was argued by McKinnon (1984 and 1986) to be inappropriate. First, Japanese groups are organised in such a way that it is often difficult to identify an ultimate parent entity. Japanese groups are characterised by a myriad of cross-equity ownership interests. Second, equity ownership is only a small part of the process that binds a group together and cultural factors were considered by McKinnon (1984, p.30) to be equally significant:

The cultural characteristic of *dantai ishiki* (group consciousness) and interdependence underlie the contemporary perceptions and attitudes of group relatedness in Japan, and are reflected in close relationships in finance, raw materials, markets and technology that form and maintain group associations.

Debt arrangements and the fact that commercial banks play a key role in most Japanese groups means that non-equity arrangements are more important in identifying group membership than in the Anglo-American countries. Third, the concept of an individual entity which is predominant in the Anglo-American context



is subsumed by group affiliation and interdependence in the Japanese context. Finally, consolidation accounting was adopted by the Ministry of Finance in Japan to primarily address the perceived low status of Japanese financial statements and was not introduced to meet the information needs of any specific user group within Japan [McKinnon (1984, p.19)]. Thus, the use of Anglo-American consolidation practices by Japanese corporate groups served ‘...only to ‘break up’ the complex and dynamic reality of those groups into a number of ‘Anglo-American type’ corporate groups, and to portray an Anglo-American perspective of something that is uniquely Japanese’ [McKinnon (1984, p.30)].

The discussion in this Section has outlined the historical development of consolidation accounting in the United States and the United Kingdom. It has been argued that the assumptions upon which consolidation accounting practices are based may have been appropriate in the early part of the Twentieth Century in an Anglo-American business environment. However, changes in the contemporary business environment of these countries bring into question the continued practice of consolidation accounting based upon the original underlying assumptions. When countries with business environments that differ significantly from those found in Anglo-American countries adopt consolidation accounting practices then questions concerning the appropriateness of such practices in these countries are also raised.

Further, it has been demonstrated that in the two principal Anglo-American countries consolidated financial statements were considered to serve different purposes. In the United States consolidated financial statements were regarded as the primary financial statements of a parent entity and its subsidiaries. In the United Kingdom consolidated financial statements have been historically required to be prepared in addition to the financial statements of the parent entity. In this context consolidated statements have been regarded as supplementary to, and amplifications of, the parent entity financial statements. These alternative disclosure rationales concerning the nature of financial

statements issued by parent entities have spread to other countries which have subsequently adopted consolidation accounting and have contributed to the current diversity in disclosure practices by parent entities. In the following Section aspects contributing to diversity in consolidation accounting practice are reviewed.

### **4.3 DIVERSITY IN CONSOLIDATION ACCOUNTING PRACTICES**

Financial statement consolidation practices vary widely. There is no comparable agreement on the meaning of an accounting entity. Consequently, a 'full range' of multinational consolidation practices is observable. Foreign subsidiaries are normally consolidated in the United States but not necessarily in Germany. In countries such as Japan, separate parent company statements are considered more important than consolidated financial statements. In other countries joint ventures are accounted for at cost, in some on the equity basis, and in still others on arithmetic percentages of ownership. Minority interests and the amounts of positive or negative goodwill arising from business mergers are also sources of practice variations. These differences relating to consolidation practices are usually considered important enough to warrant the first (and presumably most important) footnote to published financial statements. [Choi and Mueller (1992, p.80)]

In this Section evidence is provided that consolidation accounting practices have varied significantly over time, among corporations, within countries and among countries. Variations in consolidation practice have contributed to the non-comparability of financial statements and have led to the development of national accounting standards on consolidation as well as more recently the development of international accounting standards on consolidation. The evidence of diversity in consolidation accounting presented in this Section provides the rationale for the development of the consolidation accounting disclosure index in Chapter 6.

Variations in consolidation accounting practice that originated in the United States and the United Kingdom have persisted in various countries to the present and may be classified into the following four broad areas:

1. The scope of the consolidated financial statements.
2. Treatment and disclosure of the outside equity interest.
3. Treatment and disclosure of goodwill (negative goodwill) arising on consolidation.
4. Treatment and disclosure of the elimination of profits or losses arising from inter-entity transactions.

The division of issues into these four broad areas is arbitrary, to the extent that all aspects of consolidation accounting practice are interrelated. However, this division provides a useful framework for discussion and identification of categories of items for inclusion in a consolidation disclosure index. In each of these broad areas of consolidation accounting practice there are many issues concerning both measurement and disclosure of items. Variations in accounting practices concerning each of these broad areas are reviewed below.

**The first broad area is the scope of the consolidated financial statements.** This broad area concerns issues such as: the criteria used to either include or exclude subsidiaries, the type of financial statements issued, the disclosure of accounting policies and the extent to which associated entities and joint venture entities are included in consolidated financial statements.

Initially in the United States and the United Kingdom the scope of consolidation practice was restricted and applied only to corporations where there was virtually a one hundred percent ownership of the equity by the parent entity [Walker (1978a, pp.280-1)]. During the 1920s it became accepted in the American literature that the scope of consolidation should be extended to encompass all corporations that were controlled by the parent entity as a result of ownership of a majority of the voting equity capital. This position was subsequently supported in the United Kingdom

[Bircher (1988, p.5)]. There was some concern about the measurement of majority ownership when indirect ownership interests in sub-subsidiaries arose. This led to the proposition that consolidated financial reports were designed to disclose the financial position of an economic entity rather than merely amplify the parent entity's financial statements. For example, in the case where a parent entity had a 51% ownership interest in a subsidiary, which in turn had a 51% ownership interest in a subsidiary, the parent entity had a direct equity of only 26% in the sub-subsidiary but could effectively control the sub-subsidiary. Thus, in the United States when the SEC defined 'majority-owned' it encompassed both direct and indirect ownership of the voting interests in subsidiaries by parent entities [Walker (1978a, p.286)].

The criteria for inclusion of subsidiaries within the scope of consolidated financial statements have expanded beyond majority ownership of voting interests to now include all 'controlled' entities in some current accounting standards. For example see International Accounting Standard No 27 [IASB (1989a, para. 1)] and Australian Accounting Standards Board Standard No. 1024 [AASB (1991, para. .9)]. The determination of control can be difficult in circumstances where a parent entity owns less than 50% of the voting equity capital. The key issue is whether control is considered to be passive or active. AASB 1024 has adopted a passive concept of control. Inclusion of subsidiaries in consolidated financial statements turns on whether the parent has a 'capacity' to exercise control over the subsidiary, and not whether this capacity is exercised. Several factors are listed to indicate the existence of control [AASB (1991, para. xvi)]:

- (a) the capacity to dominate the composition of the board of directors or governing board of another entity;
- (b) the capacity to appoint or remove all or a majority of the directors or governing members of another entity;
- (c) the capacity to control the casting of a majority of the votes cast at a meeting of the board of directors or governing board of another entity;
- (d) the capacity to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of another entity,

irrespective of whether the capacity is held through shares or options;  
and

(e) the existence of a statute, agreement, or trust deed, or any other scheme, arrangement or device, which, in substance, gives the entity the capacity to enjoy the majority of the benefits and to be exposed to the majority of the risks of that entity, notwithstanding that control may appear to be vested in another party.

In contrast the IASC has adopted a more active concept of control which relies upon 'power' rather than 'capacity'. IASC (1989a, para. 10) states:

Control also exists even when the parent owns one half or less of the voting power of an enterprise when there is:

(a) power over more than half of the voting rights by virtue of an agreement with other investors;

(b) power to govern the financial and operating policies of the enterprise under a statute or an agreement;

(c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body; or

(d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body.

The inclusion of subsidiaries within the scope of consolidated financial statements based on the concept of either active or passive control has been accepted by the IASC and the accounting standard setting bodies in Australia, Canada, New Zealand and the United Kingdom. In the United States the FASB is currently reconsidering its position on the identification of subsidiaries to be included in consolidated financial statements. FASB (1994) outlined the preliminary views of the Board concerning changing the principal criteria for inclusion of subsidiaries from 'majority ownership' to 'control'. The above discussion demonstrates that there remains diversity concerning the criteria used to identify subsidiaries for inclusion in consolidated financial statements.

Circumstances that could lead to the exclusion of a subsidiary from consolidated financial reports were also considered in the initial phase of the development of

consolidation accounting. The first general group of subsidiaries to be excluded from consolidated financial statements were on the grounds that the subsidiaries operated in dissimilar lines of business. This has been subsequently referred to as the 'nonhomogeneity' rule [FASB (1991, p.1)]. This practice was generally applied so as to exclude banking and finance subsidiaries from the consolidated accounts of manufacturing and industrial corporations. The SEC in Rule 4-09 of Regulation S-X prohibited the consolidation of subsidiaries in the following classes of business: '...life insurance, fire and casualty insurance, securities broker-dealer, finance, savings and loan or banking, including bank related finance' [Walker (1978a, p.288)]. Thus, the practice of excluding certain subsidiaries from consolidated financial statements because of the nature of their business operations was accepted. The nature of this type of exclusion contributed to the diversity of consolidation accounting practice and has persisted to the present in some countries (see Section 4.4).

Another class of subsidiaries which could be excluded from consolidated financial statements was those classified as foreign subsidiaries. When consolidation practices were initially developed this type of exclusion was not practised. However, with restrictions on foreign currency transfers in the 1930s and the outbreak of World War II in 1939 the practice of excluding foreign subsidiaries from consolidated accounts became more widespread because of restrictions on the transfer of funds and a perceived inability of parent entities to exercise control over foreign subsidiaries. Accounting Research Bulletin No. 4 [AICPA (1939)] recommended three alternative disclosure treatments for foreign subsidiaries and were discussed by Walker (1978a, pp.289-90). These three alternative treatments were:

1. Non-consolidation of foreign subsidiaries with separate disclosures of foreign investments.

2. Consolidation of foreign subsidiaries with accompanying parent entity financial statements with separate information about investments and income from foreign subsidiaries.
3. Presentation of two sets of consolidated statements, one including and the other excluding foreign subsidiaries.

Thus, the practice of excluding some or all foreign subsidiaries from consolidated financial statements was accepted and this has continued to the present. For example, International Accounting Standard No. 27 [IASB (1989a, para. 29(b))] permits exclusion of subsidiaries from consolidation when there are long term restrictions on the ability of a subsidiary to transfer funds to the parent entity.

Other reasons for the exclusion of subsidiaries from consolidated financial statements have been proposed in the accounting literature and by accounting rule making bodies at various times. Some of these reasons were:

1. The subsidiary was immaterial or insignificant in the consolidated accounts and only material subsidiaries should be included [Walker (1978a, p.245)].
2. The subsidiary was in a promotional, exploratory or development stage and should be excluded. (SEC Accounting Series Release No. 65 (1948) in fact prohibited the consolidation of such subsidiaries [Walker (1978a, p.335)]).
3. Inclusion of the results of the subsidiary would lead to the preparation of misleading consolidated statements, because for example, the subsidiary was loss making [Walker (1978a, p.359)].
4. Inclusion of the subsidiary in the consolidated statements would be 'harmful' to either the parent entity or the subsidiary [Walker (1978a, p.359)].

5. Control of the subsidiary was only temporary or the management intended to dispose of the subsidiary. (International Accounting Standard No. 27 [IASC (1989a, para 29(a))] currently permits exclusion of subsidiaries from consolidation for this reason.)
6. The parent entity was unable to effectively control the subsidiary because of some law, custom or economic condition such as bankruptcy [Walker (1978a, p.359)].
7. Accounting practices of the subsidiary differed from those of the parent entity or other subsidiaries in the group [Walker (1978a, p.359)].
8. The outside equity interest in the subsidiary was large in comparison to the parent entity interest [Walker (1978a, pp.195, 271, 359)].

Adding the issues of dissimilar industries and foreign subsidiaries to the above list, there were at least ten grounds on which subsidiaries could be excluded from consolidated financial statements. Although the exclusion of subsidiaries has been significantly restricted in the Anglo-American countries in contemporary accounting standards, the exclusion of subsidiaries for the above reasons has been allowed in many other countries (see Section 4.4).

The inclusion or exclusion of subsidiary entities from the scope of consolidated financial statements has provided a source of diversity in consolidation accounting practices. Two other types of entities related to the scope of consolidated financial statements are associated companies and incorporated joint venture entities. The distinction between a subsidiary entity and either an associated company or an equity joint venture is a fine point and has proved problematic for accounting standard setters and the preparers of corporate accounts. For example, International Accounting Standard No. 3 [IASC (1976)] applied to both subsidiary and associated entities.



Associated companies are generally defined to be entities over which the parent entity can exert 'significant influence' as a result of owning equity capital. On the other hand subsidiary entities are those over which the parent entity can exercise 'control' whether or not any equity capital is owned. The distinction between 'significant influence' and 'control' can be difficult to determine, particularly in situations where the parent entity owns less than 50% of the equity voting capital of an entity. The decision to account for an entity as either a subsidiary or an associate significantly affects the scope of the consolidated financial statements. If an entity is treated as a subsidiary then the values of the individual assets and liabilities are included on the consolidated balance sheet together with any outside equity interest in the subsidiary. However, if an entity is treated as an associate, then by applying the principles of equity accounting, the investment account in the consolidated balance sheet is adjusted to reflect the parent entity's share in the net assets of the associate. Using this method no outside equity interest is reported on the consolidated balance sheet in respect of associated companies.

In the case of equity joint venture entities their distinction from subsidiary entities turns on the '...existence of agreements that cement the co-operative intent of the participants, and provide for joint management and control. This typically takes the form of a shareholders' agreement and agreements between the participants and their jointly owned company' [Edey (1985, p.3)]. Thus, a joint venture entity is one where a parent entity has 'joint control' and this is contrasted with a subsidiary entity where a parent entity has 'control'. The classification of entities as either joint ventures or subsidiaries affects the scope of consolidated financial statements. The accounting treatment of joint venture entities differs from that for subsidiaries. Two alternative practices have gained widespread acceptance to account for joint venture entities. The first is to account for them in the same way as associated entities by using the equity method. The second method is to account for them using

proportional consolidation. The decision to use either of these methods affects the assets, liabilities, shareholders' equity and net income reported in the consolidated financial statements.

The above discussion concerning the scope of consolidated financial statements indicates that in practice it could be expected to find a wide range of entities either included or excluded from consolidated financial statements for various reasons. This diversity of practice impairs the comparability of consolidated financial statements. Unless disclosure is made of the policy used to either include or exclude subsidiaries from the consolidated statements users of the reports would be unaware of the scope of the reports. The need for this type of disclosure also applies to associated entities and incorporated joint venture entities. Alternative accounting disclosure practices include specific identification of non-consolidated subsidiaries, consolidation of only material subsidiaries and disclosure in the notes to the accounts, inclusion and identification of associated companies included in consolidated accounts, inclusion and identification of joint venture entities included in consolidated accounts, or non-disclosure of any information concerning the scope of the consolidated financial statements.

**The second broad area is the treatment and disclosure of the outside equity interest** (often referred to as the 'minority interest'). Initially in the United States only subsidiaries that were nearly one hundred percent owned by the parent entity were included in consolidated financial statements. Under these circumstances the existence of an outside equity interest was often ignored or excluded from consolidated financial statements [Walker (1978a, p.296)]. As consolidation practice expanded to include majority owned subsidiaries the issue of the treatment and disclosure of the outside equity interest in consolidated financial statements saw a diversity of practices emerge. The choice was between disclosing the outside equity interest as a liability, as part of consolidated shareholders' equity, or as an item

located between liabilities and consolidated shareholders' equity. Clark (1993) traced the evolution of various concepts of the minority interest. These alternatives arose because of differing views concerning the purpose of consolidated financial reports. If the consolidated statements were designed to amplify the parent entity's financial statements then it was argued that the outside equity interest should be treated as a liability. On the other hand if the consolidated statements reported on the group as a single entity then the outside equity interest should be reported as part of the equity of the group. Accounting practice in the United States up to the 1930s did not generally involve the aggregation of liabilities and, in this circumstance, Walker (1978a, p.297) argued it was '...generally impossible to tell whether minority interest is considered as a liability or not.'

A related issue concerns the calculation of the amount of the outside equity interest. Generally, three main alternatives emerged [Walker (1978a, p.299)]. First, the issued capital was reported in the consolidated balance sheet as a disaggregated amount between the parent equity and the outside equity interest but the retained earnings and reserves were reported as a single amount. Second, the issued capital, retained earnings and reserves were reported in the consolidated balance sheet as disaggregated amounts between the parent equity and the outside equity interest but no total for outside equity interest was reported in the consolidated balance sheet. Third, the outside equity interest was reported in the consolidated balance sheet as a separate amount for issued capital, retained profits and reserves, and was totalled. The above alternative disclosures concerning the outside equity interest have been transferred to other countries (see Section 4.4) although in the United States the SEC now requires disclosure following the third alternative described above.

Associated with the alternative disclosure practices of the outside equity interest on the consolidated balance sheet was a second related issue concerning treatment of the outside equity interest on the consolidated income statement. The main alternatives

adopted were: First, disclosure of the aggregate group income with no amount identified as being attributable to the outside equity interest; second, disclosure of only the income attributable to the parent entity interest; third, disclosure of aggregate group income with the outside equity interest's share deducted as an expense; and fourth, disclosure of the aggregate group income with the outside equity interest's share reported as an appropriation of profits. Walker (1978a, p.302) argued these alternative practices arose because there was confusion concerning the purpose and function of consolidated accounts.

The treatment and disclosure of pre-acquisition profits of the subsidiary in consolidated financial statements provided another issue where alternative practices arose. These alternatives were closely related to the treatment and disclosure of the outside equity interest. The practice initially adopted in the United States was to treat any pre-acquisition profits distributed by the subsidiary as being reductions in the cost of the investment by the parent entity rather than as distributable profits. The treatment of pre-acquisition profits of subsidiaries in consolidated statements however became the source of accounting diversity when the American Institute of Accountants' Special Committee on Cooperation with Stock Exchanges stated: 'Earned surplus of a subsidiary company created prior to acquisition does not form part of the consolidated earned surplus of the parent company and subsidiaries; nor can any dividend declared out of such surplus properly be credited to the income account of the company' [May (1936, p.121)]. The above recommended treatment had the effect of excluding both the parent entity's share of undistributed pre-acquisition profit and the outside equity interest's share of pre-acquisition profit from the consolidated balance sheet. Walker (1978a, pp.312-3) argued the above treatment of pre-acquisition profits recommended by the Committee had the effect of varying the amount of goodwill on consolidation and was not primarily concerned with the reporting of profits on the consolidated income statement.

Subsequent practice has distinguished between the pre-acquisition profits of the subsidiary attributable to the parent entity and the outside equity interest. The treatment of pre-acquisition profits has been integral to various concepts of consolidation accounting that have arisen. For example, the inclusion of the outside equity interest's share of pre-acquisition profits in consolidated shareholders' equity is a feature of the entity concept of consolidation [Leo (1987, p.51)]. The outside equity interest's share of pre-acquisition profits is reported as a liability on the consolidated balance sheet when the parent entity concept of consolidation is applied [Leo (1987, p.36)]. However, if the outside equity interest's share of pre-acquisition profits is excluded from the consolidated balance sheet then this is consistent with the proprietary concept of consolidation accounting [Leo (1987, p.28)]. Thus, whether to include or exclude pre-acquisition profits of subsidiaries as part of consolidated equity produced another source of diversity in consolidation accounting practice.

The above discussion of alternative practices concerning disclosure of the outside equity interest on the consolidated balance sheet and income statement have persisted in corporate practice to the present in many countries despite the current development of prescriptive disclosure regulations in Anglo-American countries (see Section 4.4).

**The third broad area is the treatment and disclosure of goodwill.** Goodwill on consolidation is generally referred to as the difference between the cost of the parent entity's equity in the subsidiary and the value of the underlying net assets acquired, if the cost of the equity in the subsidiary is greater than the value of the net assets acquired. If the opposite circumstance occurs, that is the cost of the equity in the subsidiary is less than the value of the net asset acquired, then this difference is referred to 'negative goodwill' (discount on acquisition). (For the purpose of the following discussion the term 'goodwill' is used to refer generally to both positive and negative goodwill unless specifically stated.) The treatment and disclosure of goodwill has remained an issue in the accounting literature and also for accounting

standard setters and regulatory agencies in most countries. Some of the main alternative treatments and disclosure practices that have developed are outlined below.

First, the measurement of goodwill is based on the difference between the cost of the parent entity's equity in the subsidiary and the value of the share of net assets acquired. The cost of parent entity equity in the subsidiary provided scope for alternative accounting practices to evolve when the acquisition was effected by the issuance of parent share capital. Alternative valuation techniques included:

1. Cost measured using the par value of shares issued.
2. Cost measured as the book value of shares issued.
3. Cost measured as the book value of shares acquired.
4. Cost measured at the market price of the parent entity's shares issued.
5. Cost measured at the aggregate of the subsidiary company's net tangible assets.

In addition to these alternatives for measuring the cost of the acquisition two alternatives for measuring the value of the net assets acquired arose. First, measuring the value of the net assets acquired at their book value in the subsidiary's accounts; and second, measuring the net assets acquired at their fair value (or market value). Predominant practice in the United States was to use the existing book values of net assets in the subsidiary to determine the value of net assets acquired. On the other hand, in the United Kingdom, where it was an acceptable practice to revalue non-current assets, common practice was to adjust the book values of the subsidiary's assets to reflect 'fair' values in order to determine the value of net assets acquired [Walker (1978a, pp.304-5)]. The determination of fair values was calculated in several ways:

1. The elimination of any overvaluation of subsidiary assets.
2. The elimination of any 'inaccurate bookkeeping' in the subsidiary accounts.
3. The revaluation of subsidiary assets to current replacement prices.
4. The revaluation of subsidiary assets to current selling prices.

Thus, depending on how the value of the net assets acquired was determined, the amount of goodwill reported in the consolidated accounts could vary significantly and impair the comparability of consolidated financial reports. The above represents diversity in consolidation accounting measurement practice.

Another source of variation in consolidation accounting practice concerned whether or not the outside equity interest in goodwill should be recognised and reported. There are essentially two alternative treatments. First, goodwill could be determined and reported in the consolidated balance sheet only by reference to the parent entity's investment in the subsidiary. This practice focused on the assumption that the consolidated financial statements were an amplification of the parent entity's financial statements. Secondly, goodwill could be determined by reference to both the parent entity's and the outside equity interest's share of the subsidiary's equity. For example if the parent entity held 60% of the subsidiary's equity voting capital, for which it paid \$1,200,000 and the fair value of the subsidiary's net assets totalled \$1,500,000 then the goodwill determined by the first alternative would be \$300,000. That is, cost \$1,200,000 less \$900,000 net assets acquired (60% of \$1,500,000). However, if the second alternative were used the goodwill reported on the consolidated financial statements would be \$500,000 which comprised \$300,000 attributable to the parent entity's interest and \$200,000 attributable to the outside equity interest. Hatfield (1927, p.448) stated the following concerning this treatment: '...in the consolidated balance sheet the full value of each of the assets is shown, although the holding company has only a fractional interest therein, it seems needlessly inconsistent in

regard to the single asset goodwill to show only part of its value and to neglect entirely that portion representing the equity of the outstanding stockholders.' The second treatment is more consistent with the concept of consolidated financial statements representing the interests of a combined economic entity. Predominant practice on this point has been to adopt the first alternative of recognising goodwill only to the extent of the parent entity's ownership interest in the subsidiary. Thus, where an outside equity interest existed the measurement of goodwill created further alternatives in consolidation accounting practice.

Once goodwill was determined the next issue that created variation in accounting practice concerned whether, and how, to amortise goodwill in the consolidated financial statements. Alternative treatments included the following:

1. No write-off of any amount of goodwill.
2. Write-off goodwill as a lump sum against shareholders' equity or specific assets.
3. Write-off goodwill on an arbitrary basis against consolidated income or consolidated shareholders' equity.
4. Write-off goodwill on a systematic basis against income using a method such as straight-line, sum of the digits or some other appropriate method.

If the last alternative was selected a wide variety of time periods over which goodwill was written off were recognised in practice ranging from only a few years up to a maximum of fifty years in the case of the Philippines [Gray, Campbell and Shaw (1984, pp.281-2)]. The treatment of goodwill in the income statement thus further contributed to the diversity of consolidation accounting measurement practices.



Another issue that contributed towards diversity concerned the measurement of goodwill in a step acquisition. That is, where the parent entity purchased equity in the subsidiary through a series of purchase transactions. In this circumstance the measurement of goodwill varied depending upon whether each purchase was treated as a separate transaction or whether each purchase was viewed as part of a single transaction. For example, if a parent entity acquired 60% of the equity of a subsidiary for \$1,200,000 when the total net assets of the subsidiary had a fair value of \$1,500,000, then goodwill of \$300,000 would be generally recognised. If at a later date the parent entity acquired another 20% for \$500,000 when the net assets of the subsidiary had a fair value of \$2,000,000 then there are two possible ways to determine goodwill. First, if the transaction is treated as a separate event then goodwill would be calculated as follows: Cost of the acquisition \$500,000 less share of net assets acquired \$400,000 (20% of \$2,000,000 net assets) implying goodwill of \$100,000 from this transaction and total goodwill of \$400,000 from the two separate acquisitions of the subsidiary's equity. However, if the purchase of the second tranche of the subsidiary's equity is viewed as part of a single transaction then the calculation of goodwill would be as follows: Cost of the acquisition of 80% of the subsidiary's equity \$1,700,000 (\$1,200,000 + \$500,000), the net assets acquired valued at the most recent valuation \$1,600,000 (80% of \$2,000,000), therefore goodwill to be recognised is \$100,000. Thus, depending upon whether goodwill is recognised separately on each purchase of a subsidiary's equity or is measured in aggregate based on the total cost to acquire the equity in the subsidiary, different amounts would be reported in the consolidated statements. In the case illustrated above this amount varied between \$400,000 and \$100,000.

The above situation is mirrored in reverse if the parent entity sells part of its equity in the subsidiary. The alternative accounting treatments revolve around the identification of the tranche of shares sold. That is, whether the shares sold and the associated goodwill should be treated on a first-in-first-out basis, last-in-first-out

basis, weighted average basis or whether specific identification of the tranche of shares is possible. These issues provide further examples of diversity in consolidation accounting measurement practices.

The above discussion concerning goodwill has been concerned with measurement practices. Disclosure issues associated with consolidated goodwill concern how to report this item in the consolidated financial statements. On the consolidated balance sheet disclosure practices vary depending on whether the amount of goodwill is positive or negative. Where goodwill is a positive amount alternative disclosure practices have included the following:

1. Separate reporting of the consolidated goodwill as an asset on the balance sheet.
2. Inclusion of consolidated goodwill with any other goodwill and reporting of this as an asset on the consolidated balance sheet.
3. Non-recognition and use of the term goodwill and reporting of an item labelled 'excess of investment in subsidiaries over book value', 'excess from consolidation with subsidiaries', 'consolidation excess', or 'consolidation surplus', and the deduction of this item from shareholders' equity [Walker (1978a, pp.308-9)].
4. The allocation of any goodwill to other assets reported on the consolidated balance sheet so that no separate amount for consolidated goodwill was reported.

In circumstances where the amount of goodwill is negative, that is where the cost of the equity acquired is less than the underlying value of the net assets acquired, then the following alternative treatments have been practised:

1. The amount of negative goodwill could be deducted from the amount of any positive goodwill reported on the consolidated balance sheet.
2. The amount of negative goodwill could be written off against the values of recorded assets on the consolidated balance sheet.
3. The amount of any negative goodwill could be reported as part of shareholders' equity.
4. The amount of negative goodwill could be regarded as deferred income and amortised to income over a specific time period.

Various alternative treatments and disclosure practices concerning goodwill in consolidated financial statements have been outlined. These originated in either the United States or the United Kingdom and have been subsequently adopted in the accounting practices of corporations headquartered in other countries (see Section 4.4). The variety of treatments and disclosures associated with goodwill has contributed to international diversity and non-comparability of consolidated financial statements. In regard to the above diversity concerning goodwill Walker (1978a, p.310) commented:

Disagreements about the calculation and presentation of 'goodwill on consolidation' were obviously linked with disagreements about the appropriate bases for the recognition and valuation of assets. However these disagreements can also be seen as reflecting uncertainty about the aims of consolidated statements.

**The fourth broad area is the treatment and disclosure of profits or losses arising from inter-entity transactions.** Inter-entity transactions concern those between the parent entity and subsidiaries or among subsidiaries within the scope of the economic entity. These types of transactions are referred to in the literature by various terms

such as; intra economic entity transactions [Eddey (1995, p.79)]; inter-company transactions [Ma, Parker and Whittred (1991, p.77)]; intra-group transactions [Walker (1978a, p.319)]; intercompany transactions [Jubb and Haswell (1993, p.364), and Leo and Hoggett (1993, p.599)]; interentity transactions [Leo (1987, p.40)]; and inter-entity transactions [Clift and Sims (1993, p.361), and Deegan (1995, p.379)]. For the purpose of general discussion in this study the term inter-entity transactions is used, except when referring to the work of an author where an alternative expression has been used.

The initial focus on such transactions in the United States concerned profits or losses arising from inter-entity sales of inventory. Generally practice involved full elimination of the revenues and expenses associated with inter-entity transactions and associated adjustments on the balance sheet. Some argued that as a matter of convenience ‘...consolidated income statements should show gross income and expenses (without elimination of intra-group transactions)’ [Walker (1978a, pp.318-9)]. An alternative practice involved recording inventories on the consolidated balance sheet without the elimination of inter-entity profit but crediting a ‘Reserve for inter-company profits’ in the consolidated shareholders’ equity.

The principle of eliminating inter-entity profits and losses was extended to other transactions between the parent entity and its subsidiaries, such as transactions involving non-current assets and non-current liabilities. The rationale behind the elimination of inter-entity profits and losses arising on these types of transactions was based on the idea that such profits or losses were not realised from the economic entity’s point of view because no transaction had occurred with an outside entity. Critics of the elimination of these unrealised profits or losses argued that in the absence of evidence of the intention to manipulate consolidated income that such eliminations ‘should not be carried to absurd lengths’ [Walker (1978a, p.320)]. This type of argument has persisted to the present where it is accepted practice in some

countries to eliminate only material inter-entity profits or losses (see Section 4.4). Also, the practice emerged not to eliminate losses arising on inter-entity transactions unless the original cost to the economic entity was recoverable. This practice has been included in International Accounting Standard No. 27 [IASC (1989a, para. 30)].

The treatment of inter-entity profits became more complex when there was either a direct or indirect outside equity interest in the economic entity. One school of thought argued that inter-entity profits were realised from the point of view of the outside equity interest and therefore only the parent entity's share of profit should be eliminated. Others developed more complex arrangements for eliminating only a proportion of the full inter-entity profits such as, '...deducting from the aggregate recorded cost data the majority interest's share of vendor's profits on transactions with affiliates' or, eliminating inter-entity profits only to the extent of '...the majority interest's share of profits 'earned' on sales to its own 'interests'' [Walker (1978a, pp.323-4)]. The above alternative practices concerning the elimination of inter-entity profits led Walker (1978a, pp.326-7) to comment:

Whereas the general view of realisation was that profits either were or were not realised in particular situations, the consolidation rules could treat profits as being partly realised. Indeed, a sale from a 75%-owned subsidiary to an 80%-owned subsidiary could lead to a profit being treated as totally unrealised, or 25% realised or 40% realised, depending on the method being used to eliminate inter-company profits.

The above diversity of practice which originated in the United States and the United Kingdom has persisted to the present. In the United States, via the efforts of the SEC, the dominant, and virtually universal practice became the full elimination of inter-entity profits. In the United Kingdom there was much greater support for proportional elimination of inter-entity profits. Walker (1978a, p.330) attributed these alternative

practices concerning the treatment of inter-entity profits to conflicting ideas concerning the purpose of consolidated financial statements.

The idea of total eliminations was commonly associated with arguments to the effect that consolidated reports depicted an 'economic entity', for by totally eliminating all the inter-entity profits the reports were concerned with cost to the group. Conversely, while arguments for proportional eliminations seem to be tied with particular views about 'realisation', they were also commonly linked with the idea that consolidated statements amplified the reports of a holding company.

The important issue to arise concerning the treatment of inter-entity profits is the need for disclosure of the accounting policy adopted by a company. Unless there is disclosure users of financial statements would not know whether or not inter-entity profits had been eliminated, and if so, what proportion. Financial statement users are dependent on corporations to provide this information because it is not possible to observe the elimination entries made, or not made, on the consolidation worksheet. Disclosure practices have varied and usually take the form of corporations including a note in their accounts stating the policy used. Examples of disclosures are: full elimination of all profits or losses arising on inter-entity transactions; elimination of all material profits or losses arising on inter-entity transactions; and, disclosure of the effects of non-eliminated profits and losses arising from inter-entity transactions.

The discussion has outlined various treatments and disclosures associated with the elimination of inter-entity profits. These alternative treatments contribute towards diversity in consolidation accounting practice and the non comparability of consolidated financial statements.

This Section has reviewed the background to four broad areas where alternative consolidation accounting practices exist. These areas were: the scope of the consolidated financial statements; the treatment and disclosure of the outside equity

interest; the treatment and disclosure of goodwill arising on consolidation; and, the elimination and disclosure of profits or losses arising on inter-entity transactions.

Analysis of disclosure issues associated with these four broad areas provides the rationale for the categories and items comprising a consolidation disclosure index developed in Chapter 6 which is used to measure the extent of consolidation disclosures in corporate annual reports. Table 4.1 summarises the relationship between the four broad areas of consolidation accounting issues and the categories comprising the consolidation disclosure index. There are three columns in the table. The first lists the four broad areas of consolidation accounting issues discussed above. The second column lists the reference to the Section in Chapter 6 where this item is discussed in the categories of the consolidation disclosure index. The third column lists the name of the category in the consolidation disclosure index.

The alternative consolidation accounting practices discussed in this Section can be traced either directly or indirectly to the United States or the United Kingdom. Despite many of these alternatives now being restricted or eliminated in the United States and the United Kingdom, many of these alternative consolidation accounting practices have been adopted in other countries. Thus, consolidated financial reports published in different countries are often prepared using a variety of accounting methods and as a result the financial reports are not comparable. In the following Section the results of surveys of consolidated financial reporting are reviewed, with an emphasis on the diversity of practice in the ten countries that are the subject of this study.

**Table 4.1: Consolidation Accounting Issues and Consolidation Disclosure Index**

<b>Consolidation Accounting Issues</b>	<b>Chapter 6</b>	<b>Consolidation Disclosure Index Category</b>
1. Scope of Consolidated Financial Statements.	6.3.1 6.3.2 6.3.3 6.3.4 6.3.5 6.3.9 6.3.10	1 Accounting policies, standards and legislation. 2 Definition of the economic entity. 3 Financial statements. 4 Subsidiaries and inter-entity transactions. 6 Exclusions from consolidation. 9 Associated companies. 10 Joint ventures.
2. Treatment and Disclosure of the Outside Equity Interest.	6.3.5	5. Outside equity interest.
3. Treatment and Disclosure of Goodwill.	6.3.7 6.3.8	7. Goodwill. 8. Treatment of goodwill.
4. Treatment and Disclosure of Inter-entity transactions.	6.3.1 6.3.4	1. Accounting policies, standards and legislation. 4. Subsidiaries and inter-entity transactions.

#### **4.4 SURVEYS OF CONSOLIDATION ACCOUNTING PRACTICES**

In this Section the results of ten international surveys that have encompassed consolidation accounting disclosure requirements and practices are reviewed. Often these surveys did not specifically focus on consolidation accounting disclosure practices, but these were surveyed as part of a broader study of corporate accounting practices. These surveys have been conducted by academics, international accounting firms, international accounting standard setting bodies and other international



agencies. The surveys discussed in this Section are summarised in Table 4.2. This Table is divided into three columns. The first column lists the author and date of the study. The second column outlines the scope of the study in terms of the number of countries surveyed. The third column summarises the consolidation issues addressed by the survey. The surveys are listed chronologically.

**Table 4.2: Surveys of National Differences in Consolidation Accounting Practice**

Study	Scope	Consolidation Issues Surveyed
[1] Fitzgerald, Stickler and Watts (1979)	64 countries; 8 included in present study; excluded Indonesia and Thailand	48 issues causing variations in consolidated reporting were identified and each country's practice was classified into one of 7 categories.
[2] Gray, Campbell and Shaw (1984)	30 countries; 7 included in present study; excluded Korea, Singapore and Taiwan	64 issues causing variations in consolidation reporting were identified and country requirements were classified into one of 4 categories and practices into one of 6 categories.
[3] United Nations Centre on Transnational Corporations (1985)	16 countries; 4 countries included in the present study; Australia, Japan, Korea, and Philippines.	139 company reports surveyed, percentage of companies making disclosures on 10 items reported.
[4] Organisation for Economic Co-operation and Development (1987)	22 countries; 2 included in current study Australia and Japan.	Approximately 60 alternative consolidation accounting issues are identified and predominant practice on each issue is documented for each country.

[5] International Accounting Standards Committee (1988)	54 countries; 7 included in current study; excluded Korea, Philippines and Thailand.	Survey of the application of IAS 3. Each country was classified into one of 6 categories.
[6] Bavishi (1989)	24 countries; 6 included in current study; excluded Indonesia, Philippines, Taiwan and Thailand.	10 consolidation accounting practices were surveyed and countries were classified into a maximum of 9 categories depending on the issue.
[7] Price Waterhouse (1991)	9 countries plus ASC; two included in current study, Australia and Japan.	10 consolidation accounting issues were surveyed and descriptions of alternative accounting practice on each item was reported.
[8] Arthur Andersen et al (1991)	9 countries plus ASC; two included in current study, Australia and Japan.	17 consolidation accounting issues were surveyed and descriptions of alternative accounting practice on each item was reported.
[9] BDO Binder (1991)	36 countries; 6 included in current study; excluded Indonesia, Philippines, Taiwan and Thailand.	Descriptions of consolidation accounting practice and regulations in each country.
[10] Coopers and Lybrand (1991)	24 countries; 5 included in current study; excluded Indonesia, Malaysia, Philippines, Taiwan and Thailand.	Descriptions of consolidation accounting practice and regulations in each country.



[1] **Fitzgerald, Stickler and Watts** (hereafter referred to as FSW) (1979) edited a survey of two hundred and sixty seven accounting principles and reporting practices in sixty four countries that was compiled from data collected from the offices of Price Waterhouse International. The survey reported the respective position on each practice as at January 1, 1979. Each practice was classified into one of the following seven categories: required, insisted upon, predominant practice, minority practice, rarely or not found, not accepted, and not permitted. A total of forty eight principles and practices related to consolidation accounting were reported in the survey and a listing of these items is reproduced in Appendix I. The following countries in this study were surveyed by FSW: Australia, Hong Kong, Japan, Korea, Malaysia, Philippines, Singapore and Taiwan. In the case of Taiwan all questions relating to consolidation were reported as 'not applicable'.

The general results concerning diversity in consolidation accounting practices reported by FSW are grouped into the four broad areas and were as follows.

The **first broad area** concerns issues related to the scope of consolidated financial statements. The practice of publishing consolidated financial statements varied from being universally accepted in some countries to being seldom or never practiced in other countries. For the countries in this study the following either required or had a predominant practice of preparing both consolidated and parent entity financial statements: Australia, Hong Kong, Japan, Korea, Malaysia and Singapore (FSW, Question 209). In the case of the Philippines the predominant practice was to prepare only consolidated financial statements in the tradition established in the United States (FSW, Question 208).

The criteria used to include subsidiaries in consolidated financial statements varied between countries. All countries in this study, except Taiwan, prepared consolidated

statements when the parent owned more than 50% of the voting share capital (FSW, Question 211). However, other criteria used for including subsidiaries in consolidated statements created more diversity in practice. If the parent entity owned more than 50% of the voting capital but less than half the voting power consolidation was not permitted in Japan, was rarely or not found in the Philippines, while in all other countries consolidation was either required or predominant practice (FSW, Question 213). However, if the parent owned less than 50% of the voting shares but had the power to control the subsidiary, consolidation was not permitted in Australia, Hong Kong, Japan, Korea, Malaysia, and Singapore and was rarely found in the Philippines (FSW, Question 214). The same response was reported for corporations which were under central and unified management, irrespective of ownership (FSW, Question 215).

The criteria used to exclude subsidiaries from consolidation also varied. Subsidiaries were required to be excluded from consolidation when parent entity control was temporary in Japan, Korea, Malaysia and Singapore. However, such exclusions were minority practice or rarely found in Australia, Hong Kong and the Philippines (FSW, Question 216). If a subsidiary operated under conditions where it had severe restrictions on the transfer of funds or parent entity control was impaired then it was required or predominant practice to exclude such subsidiaries from consolidation in Japan, Korea, Malaysia, Philippines and Singapore. Such exclusions were minority practice or not found in Australia and Hong Kong (FSW, Question 217). Exclusion of subsidiaries on the grounds of dissimilar business was predominant practice in Hong Kong, Japan and Philippines. This type of exclusion was a minority practice or rarely found in Australia, Korea, Malaysia and Singapore (FSW, Question 218). The disclosure of the reason for exclusion of a subsidiary from consolidated financial statements was either required or predominant practice in all countries (FSW, Question 219).

The treatment of unconsolidated subsidiaries, which were excluded from consolidation on the grounds of dissimilar business, also varied. The dominant practice was to equity account these subsidiaries in the consolidated accounts and this was either the required or predominant practice in Hong Kong, Japan, Korea, Malaysia, and Singapore (FSW, Question 238). Recording the investment in unconsolidated subsidiaries at cost was only reported as a predominant practice in the Philippines (FSW, Question 239). In the case of Australia both practices were reported to be rarely or not found respectively. The use of equity accounting for 50% owned corporations which were not subsidiaries was required in Malaysia and Singapore, a minority practice in Australia, Hong Kong, Japan and the Philippines, and was not permitted in Korea (FSW, Question 102). The treatment of joint ventures also varied. Investments in corporations where there was a joint venture relationship were predominantly accounted for using equity accounting in Malaysia, the Philippines and Singapore (FSW, Question 106). However, if joint ventures were unincorporated then equity accounting was predominantly used in Australia, Malaysia, the Philippines and Singapore (FSW, Question 108). In the other countries there was not reported to be a predominant or required method of accounting for either incorporated or unincorporated joint ventures.

The treatment of unconsolidated subsidiaries, which were excluded from consolidation on the grounds of dissimilar business, also varied. The dominant practice was to equity account these subsidiaries in the consolidated accounts and this was either the required or predominant practice in Hong Kong, Japan, Korea, Malaysia, and Singapore (FSW, Question 238). Recording the investment in unconsolidated subsidiaries at cost was reported as a predominant practice only in the Philippines (FSW, Question 239). In the case of Australia both practices were reported to be rarely or not found. The use of equity accounting for 50% owned corporations which were not subsidiaries was required in Malaysia and Singapore, a minority practice in Australia, Hong Kong, Japan and the Philippines, and was not

permitted in Korea (FSW, Question 102). The treatment of joint ventures also varied. Investments in corporations where there was a joint venture relationship were predominantly accounted for using equity accounting in Malaysia, the Philippines and Singapore (FSW, Question 106). However, if joint ventures were unincorporated then equity accounting was predominantly used in Australia, Malaysia, the Philippines and Singapore (FSW, Question 108). In the other countries there was no predominant or required method of accounting for either incorporated or unincorporated joint ventures.

In terms of the **second broad area** there were no questions posed by FSW concerning the treatment and disclosure of outside equity interests in consolidated financial statements.

The **third broad area** concerning diversity in the treatment and disclosure of goodwill arising on consolidation was surveyed. In the calculation of goodwill, the value of the assets acquired could be determined at either their fair value or book value. The use of fair value was the predominant practice in Japan, Malaysia, Philippines and Singapore (FSW, Question 229). In contrast, the use of book value was either required or predominant practice in Australia, Hong Kong and Korea.

The treatment of goodwill after recognition also varied between countries. Four alternatives were considered: First, goodwill was amortised systematically over a defined period. This was either required or predominant practice in Japan, Korea and Philippines (FSW, Question 231). Second, goodwill was amortised against income on an arbitrary basis. This was not required nor predominant practice in any country, although it was reported as a minority practice in Australia, Malaysia and Singapore (FSW, Question 232). Third, goodwill was written off directly to retained earnings. This was not required nor a predominant practice in any country, although it was reported to be a minority practice in Hong Kong, Malaysia and Singapore (FSW,

Question 233). Fourth, goodwill is not written down nor amortised until it is apparent that it has diminished in value. This was the predominant practice in Australia, Hong Kong, Malaysia and Singapore (FSW Question 234).

The treatment of negative goodwill also varied between countries. Two alternatives were documented. First, allocation of the 'discount on acquisition' to reduce proportionately the values of either non current or non monetary assets was predominant practice in the Philippines. In all other countries this was either rarely found or not permitted (FSW, Question 235). Second, the amount of 'discount on acquisition' could be reported as negative goodwill in shareholders' equity. This was predominant practice in Australia, Hong Kong, Malaysia and Singapore (FSW, Question 237). In Japan and Korea there was no permitted treatment for negative goodwill.

In terms of the **fourth broad area** some questions were posed concerning the diversity of treatment for the elimination of profits or losses arising on inter-entity transactions when a subsidiary was partly owned. When a parent sold goods to a partly owned subsidiary only Australia predominantly eliminated profit to the extent of the parent's interest (FSW, Question 222). However, if a partly-owned subsidiary sold goods at a profit to its parent, then it was predominant practice in Australia, Japan and Korea to eliminate the profit only to the extent of the parent's interest. In all other countries the full elimination of inter-entity profits was either required or predominant practice (FSW, Question 221).

The above discussion of consolidation accounting practices and disclosures in the eight countries of the Asia-Pacific region included in the survey by FSW demonstrates a great deal of diversity at the time concerning the four broad areas.



[2] **Gray, Campbell and Shaw** (hereafter referred to as GCS) (1984) edited the results of a survey of approximately four hundred accounting disclosure requirements and practices in thirty countries. The information for this survey was sourced from the network of offices of Deloitte Haskins and Sells International and represented the situation in each country as at January 1, 1982. Results of the survey were reported for each accounting practice in two categories. First, there was a listing of the current requirements concerning accounting practice which were classified as either: required, recommended, permitted, or not permitted. Second, there was an estimate of the extent to which that practice was being used by large companies in each country. The estimate was divided into six bands: A: 91-100%; B: 76-90%; C: 51-75%; D: 26-50%; E: 11-25%; F: 1-10%. Sixty five issues with respect to consolidation accounting practice were surveyed. A complete listing of these items is reproduced in Appendix 1. The following seven countries from the Asian-Pacific region were included in the survey: Australia, Hong Kong, Indonesia, Japan, Malaysia, Philippines, and Thailand.

In terms of the **first broad area** the results of the survey were as follows. The scope of the consolidated financial statements varied among the countries depending on the relationship between the parent entity and the subsidiary. All countries required consolidation when a parent entity owned more than 50% of the voting capital (GCS, p.230). However, if a parent entity owned more than 50% of the equity capital but less than 50% of the voting capital consolidation was not permitted in Japan and Thailand, while it was either required or permitted in the other countries (GCS, p.231). The same situation existed when the investor entity owned less than 50% of the voting capital but could control the board of directors of the investee company (GCS, p.231). In the case where the investor entity owned less than 50% of the voting capital but could control the policy decisions of the investee company consolidation was not permitted in Hong Kong or Thailand, while it was either permitted or required in the other countries (GCS, p.233). If two entities were under central and unified

management consolidated accounts were either required or permitted in Indonesia and the Philippines, while they were not permitted in all other countries (GCS, p.234).

Subsidiaries were required to be excluded from consolidation because of dissimilar lines of business in Japan, and this was recommended practice in Indonesia and Thailand (GCS, p.247). All other countries permitted exclusion from consolidation for this reason. If control of a subsidiary was temporary then exclusion from consolidation was required in Indonesia, Japan, Malaysia and the Philippines. This type of exclusion was permitted in Australia and Thailand but not permitted in Hong Kong (GCS, p.248). If a subsidiary operated under severe restrictions that affected parent entity control then the subsidiary was required to be excluded from consolidation in Indonesia, Japan and Malaysia. Such exclusion was recommended in the Philippines, permitted in Australia and Thailand but not permitted in Hong Kong (GCS, p.249). If consolidation of a subsidiary would involve undue expense and delay it was permitted to exclude the subsidiary from consolidation in Australia, Hong Kong, Indonesia, Malaysia, Philippines and Thailand. This type of exclusion was not permitted in Japan (GCS, p.250). If consolidation of a subsidiary would be misleading or harmful then it was required to exclude the subsidiary from consolidation in Indonesia and Japan. Australia, Hong Kong, Malaysia, Philippines and Thailand permitted exclusion from consolidation for this reason (GCS, p.251). Subsidiaries could be excluded from consolidation for some other unspecified reason in Indonesia, Japan and Thailand while this was not permitted in Australia, Hong Kong, Malaysia and the Philippines (GCS, p.252).

The form of consolidated financial statements could vary with only Japan requiring consolidated accounts in all cases (GCS, p.245). Either separate financial statements for some group members could be published with the consolidated accounts or two or more sets of consolidated accounts for sub-groups of the economic entity could be published in Australia, Hong Kong, Indonesia, Malaysia, Philippines and Thailand

(GCS, pp.260-1). The parent entity was required to publish a separate balance sheet in all countries except the Philippines where this was a recommended practice (GCS, p.254). Publication of the parent entity income statement was required in all countries except Hong Kong and the Philippines (GCS, p.255). In the case of the parent entity's funds statement this was required to be published in only Indonesia and Thailand but was either a recommended or permitted practice in all other countries (GCS, p.256).

Disclosures concerning subsidiary companies in consolidated accounts also varied between the countries. Only in Australia and Malaysia was information required to be disclosed concerning all subsidiaries (GCS, p.241). Information concerning principal subsidiaries was required in Hong Kong and Thailand, was recommended practice in the Philippines and permitted practice in Indonesia and Japan (GCS, p.240). The types of information disclosed concerning subsidiaries also varied. Disclosure of the names and locations of subsidiaries was required only in Australia, Hong Kong, Japan and Malaysia (GCS, pp.236-7). Only Malaysia required disclosure of the activities of subsidiaries (GCS, p.238). Disclosure of the percentage of shares held by the parent entity in the subsidiary was only required in Australia, Hong Kong and Thailand (GCS, p.239).

The use of equity accounting for associated companies was required in Malaysia, recommended practice in Hong Kong and the Philippines, and permitted practice in Australia, Indonesia, Japan and Thailand (GCS, p.291). There were no survey questions concerned with accounting and disclosure of interests in joint ventures.

In terms of the **second broad area** GCS provided evidence that the disclosure of the outside equity interest in the consolidated balance sheet varied between the countries. Hong Kong, Japan, Malaysia and the Philippines did not permit this item to be included in the consolidated equity but required it to be reported between consolidated equity and liabilities. Australia, Indonesia and Thailand permitted the outside equity

to be reported as part of the consolidated equity or as a separate item between consolidated equity and liabilities (GCS, pp.272-3).

The **third broad area** concerning the measurement and disclosure of goodwill also provided a source of diversity between the countries. Goodwill could be measured at either the difference between the cost and fair value of net assets acquired, or the difference between the cost and book value of the net assets acquired at either the date of acquisition or the date of the balance sheet. The first alternative was required in Hong Kong, recommended in the Philippines, not permitted in Japan but permitted in Australia, Indonesia, Malaysia and Thailand (GCS, p.274). The second and third alternatives were required in Japan, not permitted in Hong Kong and the Philippines but permitted in Australia, Indonesia, Malaysia and Thailand (GCS, pp.275-6). Goodwill was not permitted to be credited to the outside equity interest in Hong Kong and Japan, however this practice was permitted in Australia, Indonesia, Malaysia, Philippines and Thailand (GCS, pp.233-4).

Six possible treatments for goodwill after its recognition were identified. Only Japan and the Philippines required goodwill to be amortised against consolidated income, while all of the other countries permitted this practice. It should be noted that the Philippines was the only country to require goodwill to be written off over a specific time period, 50 years (GCS, pp.281-2). The indefinite carry forward of goodwill was not permitted in Hong Kong and Japan but permitted in all other countries (GCS, p.277). The carrying forward of goodwill until disposal of the subsidiary was not permitted in Japan but permitted in all other countries (GCS, p.278). Immediate write off of goodwill to the income statement was not permitted in Japan and the Philippines but permitted in all other countries (GCS, p.279). The immediate write off of goodwill to reserves was not permitted in Australia, Japan or the Philippines but was permitted in all other countries (GCS, p.280). Disclosure of the amount of goodwill carried forward, the amount of goodwill written off and the policy for the

treatment of goodwill were required only in Hong Kong, Japan and Malaysia. All other countries either permitted or recommended these types of disclosure.

In terms of the **fourth broad area** all countries required elimination of intra-group sales and loans except Thailand where this was a permitted practice (GCS, pp.265-6). However, there were variations concerning the extent of the elimination. The Philippines was the only country which recommended that only the parent entity's share of unrealised profits and losses be eliminated, while this was a permitted practice in Australia, Indonesia, Japan, Malaysia and Thailand. Hong Kong did not permit this practice (GCS, p.270). Full elimination of both the parent entity's and outside equity interest's share of unrealised profits was required in Hong Kong and Indonesia, while this was a permitted practice in all of the other countries (GCS, p.271). The disclosure of intra-group sales, loans and guarantees was only required to be made in Malaysia, while all other countries permitted this disclosure (GCS, pp.267-9).

The above evidence provided by GCS indicated a wide variety of consolidation accounting practices and disclosures in the seven Asian-Pacific countries at the time of their survey.

**[3] United Nations Centre on Transnational Corporations** (hereafter referred to UNCTC) (1985) published the results of a survey of 139 annual reports of transnational corporations from 16 countries. Four of these countries were from the Asian-Pacific region and the number of corporate annual reports surveyed from each country is shown in brackets: Australia (5), Japan (16), Philippines (2) and Korea (2) [UNCTC (1985, p.91)]. The results of the survey were not reported on a disaggregated basis by country. A total of 128 companies (or 92%) published consolidated accounts where subsidiaries were identified on the criteria of majority ownership of voting equity capital. The survey provided no further empirical

evidence concerning specific consolidation accounting practice in individual countries. Thus, it is not possible to discuss this study in terms of the four broad areas of consolidation accounting practice. The significance of this survey is that corporate annual reports were used as the source of data.

**[4] The Organisation for Economic Co-operation and Development** (hereafter referred to as OECD) (1987) published a survey of consolidation policies in its member countries as at June 1986. Two countries from the Asian-Pacific region that are the subject of this study are members of the OECD, Australia and Japan. The significance of the OECD report was the identification and documentation of over sixty alternative consolidation accounting requirements and disclosure policies. A listing of all these alternatives is reproduced in Appendix 1. The following twelve areas of variation in consolidation practice were identified [OECD (1987, p.5)]:

1. Scope of the consolidation
2. Acquisition or disposal of entities subject to consolidation in the course of the financial year.
3. Exemptions
4. Proportional consolidation.
5. Exclusion of entities from consolidation.
6. Consolidation procedures.
7. Co-terminous year ends.
8. Uniformity of accounting policies.
9. Disclosure requirements.
10. Presentation of consolidated financial statements.
11. Legal status and use of consolidated financial statements.
12. Accounting for investments in entities not subject to consolidation.

Most of the above twelve areas relate to issues associated with the scope of consolidated financial statements, as defined in Section 4.3, which was the first broad area of consolidation accounting practice identified in this study. Some questions were directed towards goodwill which was the third broad area, but no questions were directed towards either the outside equity interest or the treatment of inter-entity transactions which were respectively the second and fourth broad areas. In the following discussion only instances where consolidation policies in Australia and Japan vary are discussed.

In terms of the **first broad area** the scope of consolidated financial statements differed between Australia and Japan in the following ways. In Japan requirements to prepare consolidated accounts only covered public limited liability companies, whereas in Australia consolidation requirements extended to private limited liability companies, companies limited by guarantee and no-liability companies [OECD (1987, p.33)]. In Australia if a parent entity was itself a wholly owned subsidiary and the ultimate parent entity was also an Australian entity then the parent was exempted from preparing consolidated financial statements. No such exemption existed in Japan [OECD (1987, p.35)]. Consolidated statements were the only permitted form of disclosure in Japan. However, in Australia if directors considered it practical, in the interests of shareholders and no significant transactions had occurred between the companies, then two or more sets of consolidated subgroup accounts, or separate accounts for each entity in the group, or a combination of the above, was permitted [OECD (1987, p.41)]. In Australia all subsidiaries were required to have co-terminous year ends. In the case of Japan closing dates could vary up to a maximum of three months [OECD (1987, p.52)]. Australian consolidated statements were required to include a statement of sources and applications of funds and a statement by directors. Japanese consolidated statements did not include the above but included a statement of consolidated surplus [OECD (1987, p.57)].

A parent / subsidiary entity relationship was only recognised in Japan if there was ownership of a majority of the voting shares. In Australia this relationship was recognised if any of the following circumstances existed: ownership of a majority of the issued shares; ability to cast a majority of the votes at a general meeting; right to control the composition of the board of directors; the ability to exercise a majority of the votes of the board; management of the entities was on a unified basis arising from the actual exercise of power of control [OECD (1987, pp.36-7)].

Subsidiaries could be excluded from consolidation for different reasons. In Australia subsidiaries could be excluded for the following reasons: undue expense and/or delay; activities different from the rest of the group; subsidiary was located abroad and there was hostilities or the threat of appropriation; the holding was temporary; there were long-term restrictions on the transfer of funds; or, if the consolidated accounts would be misleading or harmful. In Japan none of the above reasons were permitted for exclusion of subsidiaries although two other reasons were permitted. First, that the subsidiary was immaterial in size and second, that the subsidiary was deemed to be no longer a going concern [OECD (1987, p.45)]. Disclosures concerning excluded subsidiaries also varied. Australia required a copy of the latest financial statements of the excluded subsidiary to be attached to the consolidated financial statements and disclosure of inter-company indebtedness. In Japan the latest financial statements of excluded subsidiaries were not required to be attached to the consolidated financial statements but information concerning the grounds for judgement in the case of immaterial subsidiaries was required to be disclosed [OECD (1987, p.47)].

Disclosure requirements concerning the economic entity also varied. Japan required the number and names of all principal non-consolidated subsidiaries to be disclosed. Australia required the book value of all investments in subsidiaries to be reported as well as information concerning the pricing of intra-group transactions [OECD (1987), p.55)]. The treatment of unconsolidated subsidiaries in Australia was based on the



cost method with inter-company dividends reported as income. In Japan equity accounting was required for unconsolidated subsidiaries and investments in companies owned 20% to 50% with any inter-company dividends deducted from the carrying amount of the investment [OECD (1987, p.60)].

In terms of the **third broad area**, the measurement and disclosure of goodwill, there were also variations between Australia and Japan. Australia required goodwill to be calculated using the fair value of the net assets acquired while in Japan the book value of the net assets acquired was used in determining goodwill [OECD (1987, p.48)]. The amortisation of goodwill was required in both countries. Australia required amortisation to income over the economic life with a maximum of 20 years allowed. Japan required straightline amortisation over 5 years [OECD (1987, p.50)]. Negative goodwill was reported as a separate item in Japan and amortised to profit. In Australia negative goodwill was assigned to reduce the identifiable non-monetary assets with any balance remaining taken up in the profit and loss in the year of acquisition [OECD (1987, p.50)].

The above completes the discussion of the OECD survey of consolidation policies. Following this the OECD published a report on accounting standards harmonisation of consolidated financial statements in member countries, OECD (1988a). Further clarification of the OECD guidelines concerning disclosures by multinational enterprises was reported in OECD (1988b). The OECD provided extensive evidence of diversity in consolidation policies among its member countries.

**[5] The International Accounting Standards Committee (IASC) (1988)** surveyed Member Bodies in 70 countries concerning their accounting standards during 1987, with responses updated in 1988. Seven countries from the Asian-Pacific region that are the subject of this study responded to the IASC survey. These were: Australia, Hong Kong, Indonesia, Japan, Malaysia, Singapore and Taiwan. The other countries

in this study (Korea, Philippines and Thailand), despite having accounting bodies that were members of the IASC, did not respond to the survey. These responding countries were classified according to their compliance with IASC standards. At the time of survey International Accounting Standard 3 (IAS 3) 'Consolidated Financial Statements' [IASC (1976)] was in force. Responses for the seven countries concerning the consolidation standard were:

1. IAS adopted as national requirement - Malaysia.
2. IAS used as the basis for a national requirement - Singapore.
3. National requirements developed separately and conforms, in all material respects, with IAS - Hong Kong, Indonesia, Japan and Taiwan.
4. No national requirements but national practice generally conforms with IAS - Australia.

The IASC survey did not investigate any specific consolidation accounting practices or disclosure policies in the member countries and therefore it is not possible to discuss the results in terms of the four broad areas of diversity in consolidation accounting practice.

[6] **Bavishi** (1989) edited the results of a survey conducted by the Center for International Financial Analysis and Research Inc., of 114 accounting standards and financial reporting practices of 2,778 industrial corporations operating in 24 countries. Six countries from the Asian-Pacific region that are the subject of this study were included and the number of corporations surveyed from each country is reported in Table 4.4. The names of the individual corporations were not disclosed, nor was the industry classification of the corporation reported by country, or the year of the financial statements used in the survey.

**Table 4.4: Number of Corporations Surveyed by Country**

Source: Bavishi (1989, p.2-3)

Country	No. of Corporations
Australia	48
Hong Kong	20
Japan	300
Korea	14
Malaysia	25
Singapore	18

Twelve of the accounting standards and financial reporting practices discussed in the survey related to consolidation accounting and disclosure practices. The results concerning these practices are discussed below in terms of the four broad areas of consolidation accounting practice.

**First**, in terms of scope of the consolidated financial statements the following observations were made. Consolidated financial statements were prepared by 80-100% of corporations in Australia, Hong Kong, Malaysia and Singapore. The incidence of consolidation was between 40-80% in Japan but only a minority practice in Korea [Bavishi (1989, Exhibit 2-1)]. All subsidiaries were included in consolidation in Australia, Hong Kong, Malaysia and Singapore. However in Japan and Korea the scope of the consolidation was to include only domestic subsidiaries with foreign subsidiaries reported at cost [Bavishi (1989, Exhibit 2-1)].

The level of information disclosed concerning subsidiaries varied between Australia which disclosed the name, headquarters, financial results and the percentage

ownership; Hong Kong, Japan and Singapore which disclosed the name, domicile and the percentage ownership; and, Korea and Malaysia which disclosed the name or domicile of the subsidiary [Bavishi (1989, Exhibit 3-1)]. The consolidation of subsidiaries where the ownership was between 20-50% but control was exerted by the parent entity was not practiced in Hong Kong, Korea, Malaysia and Singapore but was a minority practice in Australia and Japan [Bavishi (1989, Exhibit 2-1)].

**Second**, in respect of the treatment and disclosure of the outside equity interest it was reported that all countries excluded the minority interest from the owners' equity section of the consolidated balance sheet. On the consolidated income statement all countries deducted minority interest before the bottom line [Bavishi (1989, Exhibit 2-1)]. Such disclosure of minority interest on the income statement was reported to be standard practice for between 40-80% of companies in Australia, Hong Kong, Japan, Malaysia and Singapore, but only a minority practice for companies in Korea [Bavishi (1989, Exhibit 3-1)].

**Third**, the treatment and disclosure of goodwill was reported to vary as follows. In Australia goodwill was capitalised and taken to reserves; in Japan and Korea it was capitalised and amortised; and, in Hong Kong, Malaysia and Singapore it was taken to reserves [Bavishi (1989, Exhibit 2-1)]. Goodwill was disclosed in consolidated statements by 80-100% of corporations in Japan and Korea, between 40-80% of corporations in Australia, Hong Kong and Singapore but was a minority disclosure in Malaysia.

**Fourth**, the elimination of inter-entity transactions and accounts upon consolidation was reported as standard practice in Australia, Hong Kong, Japan, Malaysia and Singapore. The practice in Korea was found to be not determinable [Bavishi (1989, Exhibit 2-1)]. The research did not explore any particular methods concerning the

elimination of inter-entity transactions which were found to vary widely in the studies by FSW (1979) and GCS (1984).

The above discussion completes the review of the survey edited by Bavishi (1989) and demonstrates from a study of disclosures in financial statements a variety of consolidation accounting practices in the four broad areas among Asian-Pacific countries that are the subject of this study.

[7] **Price Waterhouse** (1991) published a survey of consolidation and equity accounting practices in nine countries plus the IASC requirements as at November 1990. The methodology of the survey was not reported. Two countries from the Asian-Pacific region, that are the subject of this study, were surveyed by Price Waterhouse and they were Australia and Japan. The survey reported on ten accounting practices. All of the differences between Australian and Japanese practice identified and discussed below were sourced from the Table entitled 'Comparison of National Accounting Practice' [Price Waterhouse (1991, pp.4-5)]. Two of the broad areas were covered by the Price Waterhouse survey: the scope of consolidated financial statements; and, the treatment of the outside equity interest.

**First** were observations concerning the scope of consolidated financial statements. Consolidation was required in the primary accounts submitted to the stock exchange in Australia but was not required in the primary accounts in Japan where consolidation was presented in supplementary accounts submitted to the stock exchange. Determination of a parent / subsidiary entity relationship was based on control of greater than 50% of the voting interest in both countries, although it was noted that a change to 'economic control' was expected in Australia. Disclosures concerning consolidated subsidiaries were not required in Australia. However, in Japan the name and a reconciliation of accounting classification for foreign subsidiaries, if different from those required in Japan, was required to be disclosed.

Proportional consolidation was not permitted in Japan. Australia permitted proportional consolidation when assets were held jointly and liabilities were several. Equity accounting for 20-50% owned entities was included in the supplementary consolidated accounts prepared in Japan. Information about the name and a reconciliation of accounting classification for foreign subsidiaries, if different from those required in Japan, was required to be disclosed concerning equity investments. In Australia equity accounting of 20-50% owned entities was not permitted to be included in the primary accounts but was required to be disclosed by a note to the financial statements. The following information concerning equity investments was required to be disclosed: name, principal activities, percentage ownership, dividends received and share of retained earnings and operating profit.

In terms of the **second broad area**, the outside equity interest, this was described as the minority interest and disclosure was reported to vary as follows. In Australia the minority interest was reported as a component of shareholders' equity on the consolidated balance sheet and as a separate line item in the income statement. In Japan minority interest was reported as the last line in the liability section of the consolidated balance sheet and as a separate line item in the income statement. In both countries the amount of the minority interest in a subsidiary was reported to be determined by reference to net assets of the investee entity valued on an historical cost basis.

[8] **Arthur Andersen** et al (1991, pp.18-22) reprinted the above Price Waterhouse survey results and reported a further seven questions concerning goodwill. Both Australia and Japan were reported to measure goodwill as the difference between the purchase price and the fair value of net assets acquired. However, the treatment of goodwill varied with Australia allowing any systematic method to amortise goodwill over a period not exceeding twenty years, and Japan requiring straightline

amortisation over five years, unless the standard of a foreign country was adopted. Also, the treatment of negative goodwill varied with Australia requiring the amount to first reduce pro rata nonmonetary assets and any excess to be credited to current income, whereas in Japan the full amount could be included in equity or amortised to income on a straightline basis over five years.

[9] **BDO Binder** (1991) published a directory of financial reporting practices in thirty six countries. Six countries from the Asian-Pacific region, that are the subject of this study were reviewed in this survey. They were: Australia, Hong Kong, Japan, Korea, Malaysia, Singapore. For each country descriptions of the current laws and accounting standards concerning group financial statements were prepared. These description confirm the variety of practices that have been documented in the above cited surveys.

[10] **Coopers and Lybrand** (1991) published a summary of the accounting standards required in twenty four countries that were effective as at January 1, 1991. Five countries from the Asian-Pacific region, that are the subject of this study, were surveyed. They were: Australia, Hong Kong, Japan, Korea, and Singapore. For each country the requirements of the standards were documented and these summaries confirm the variety of practices and requirements reported in the above cited surveys.

In summary, this Section has reported evidence of the diversity of consolidation accounting practices and disclosures for ten countries from the Asian-Pacific region. The methodology used in these surveys has varied. Corporate annual reports were used as a the primary source of data in the surveys carried out by the UNCTC (1985) and Bavishi (1989). Opinions from various offices of international accounting firms were used in the surveys carried out by FSW (1979), GCS (1984), Price Waterhouse International (1991), Arthur Andersen et al (1991), BDO Binder (1991) and Coopers and Lybrand (1991). The OECD (1987) surveyed its member countries concerning

consolidation policies and practices. The IASC (1988) surveyed its Member Bodies concerning compliance with its consolidation accounting requirements. The evidence of diversity in consolidation practices from all sources was overwhelming. Throughout the above discussion observations of diversity in consolidation accounting practice have been divided into the four broad areas of difference identified in Section 4.3. Given the above evidence, it is little wonder that the attempt to harmonise consolidation practices and disclosures has been high on the agenda of the IASC. In the following Section this endeavour is reviewed.

#### **4.5 HARMONISATION OF CONSOLIDATION ACCOUNTING PRACTICES**

In this Section attempts to harmonise consolidation accounting practices internationally are reviewed. Concern over the diversity of consolidation accounting practices has been associated with attempts to harmonise international accounting differences from the early 1970s. Prior to the establishment of the IASC in 1973, the Accountants International Study Group (AISG), which had a membership of professional accounting bodies from Canada, the United Kingdom and the United States, reported on diversity of consolidation accounting practices in these countries [AISG (1973)]. Within one year of the establishment of the IASC an exposure draft entitled 'Consolidated Financial Statements and the Equity Method of Accounting' was published [IASC (1974)]. As was discussed in Section 4.2 above, the origins of the diversity in consolidation accounting practice in the United States and the United Kingdom can be traced to divergent views concerning the nature and function of consolidated financial statements that emerged in the early Twentieth Century. The diversity of practices that the AISG and IASC endeavoured to resolve were thus deep seated and complex and prompted Walker (1978b, pp.98-9) to comment:



Presumably both the AISG and IASC would have compared the accounting standards and disclosure rules which were operative in different countries. In the course of this comparison, both organisations would have encountered inconsistencies in rules dealing with the use and preparation of consolidated reports. These inconsistencies relate to fundamental questions: when should consolidated statements be prepared and published; should they be presented alone or in conjunction with parent company reports; what firms should be included or excluded from the scope of consolidation - and so forth.

The IASC published IAS 3 'Consolidated Financial Statements' [IASC (1976)] after the exposure draft had passed the due process, and it became effective from January 1, 1977. IAS 3 was a controversial accounting standard and from early on was severely criticised. For example, Walker (1978b, p.109) stated: '...IAS 3 has serious technical deficiencies'. In addition, because the IASC was a relatively young organisation when IAS 3 was issued there was much pressure to produce accounting standards relatively quickly and so the IASC compromised on many points of diversity in consolidation accounting practice to achieve agreement among its members at the expense of theoretical reasoning and technical soundness [see Walker (1978b)]. Thus, IAS 3 did little, if anything, to improve the comparability of consolidated financial statements and to reduce diversity in consolidation accounting practice. The surveys of diversity in consolidation accounting practice, reviewed in Section 4.4, were all conducted during the time that IAS 3 was operative. The continued diversity of consolidation accounting practice after the introduction of IAS 3 eventually led to its withdrawal and replacement.

The studies by FSW (1979), GCS (1984), UNCTC (1985) and OECD (1987) together with general criticisms of the diversity of consolidation accounting practice contributed to the IASC placing the issue of consolidation accounting back on its agenda [see for example, Parker (1979), Most (1984) and Nobes (1985)]. A 'conformity index' of compliance with IAS 3 was calculated at 84.91% by Diamond,

Gernon and Purvis (1989, p.46). The above criticisms contributed to the IASC issuing Exposure Draft 30 (E 30) 'Consolidated Financial Statements and Accounting for Investments in Subsidiaries' [IASC (1987)]. This was followed by IAS 27 'Consolidated Financial Statements and Accounting for Investments in Subsidiaries' [IASC (1989a)] with an effective date of January 1, 1990. None of the studies reviewed in Section 4.4 above, that used financial statements as a data source, was conducted in the period since IAS 27 has been operative. There appears to be no published study of the impact of IAS 27 on the comparability of consolidated financial disclosures.

The principal issues and requirements of IAS 27 are discussed below. IAS 27 separated the treatment of subsidiaries from associated companies which were both covered by IAS 3. Also, IAS 27 specifically excluded the treatment and disclosure of interests in joint venture from its scope (para. 5(c)). The requirement for the consolidation of all entities over which a parent entity exercised control, both domestic and foreign, was introduced by IAS 27 with only two exceptions. These were, if control of the subsidiary was intended to be temporary, or if the subsidiary operated under severe long-term restrictions which impaired its ability to transfer funds to the parent (para. 29(a) (b)). The investment in unconsolidated subsidiaries was required to be reported in the consolidated statements at cost or by using equity accounting. If a subsidiary was not included in consolidated statements the reason for non consolidation was required to be disclosed (para. 37(b)(i)). Other information required to be disclosed about subsidiaries included: the name of significant subsidiaries; country of incorporation or residence; proportion of ownership interest held; and proportion of voting power held if different from the ownership interest (para. 37(a)). If a subsidiary was included in the consolidated statements and the parent did not own more than half the voting power then the nature of the relationship between the parent and subsidiary should be disclosed (para. 37(b)(ii)). Likewise, where an entity owned more than half the voting power of an investee entity, but

could not exercise control, and therefore did not include the entity in consolidated statements, then the name of the entity was required to be disclosed (para. 37(b)(iii)).

Elimination of intragroup balances, transactions and unrealised profits was required in full (para. 30). However, only losses arising from intragroup transactions that were recoverable at cost to the economic entity were required to be eliminated (para. 30). Balance dates of entities in the consolidation could vary by up to three months with adjustments required only for significant transactions (para. 31). Different accounting policies by members of the group were permitted if it was not practicable to use uniform accounting policies. If this occurred then this fact was recommended to be disclosed (para. 32). Minority interests were required to be reported in the consolidated balance sheet separately from the parent entity's shareholders' equity and liabilities. In the consolidated income statements minority interests were also required to be separately reported (para. 33).

The above discussion of the main provisions of IAS 27 indicates that it went some way towards restricting diversity in consolidation accounting practices and disclosure. However, there were still many choices permitted in the standard. For example: inclusion or exclusion of subsidiaries, use of uniform accounting policies within the group, and uniformity of financial years within the economic entity. Also, there was a failure to address issues in detail where there was evidence of alternative accounting practices. For example: full elimination of unrealised profits but only partial elimination of unrealised losses, treatment and disclosure of minority interests and additional information only concerning 'significant' subsidiaries. IAS 27 thus provided scope for many alternative consolidation accounting practices to be continued. The problem of diversity in consolidation accounting practice was to remain.

IAS 28 'Accounting for Investments in Associates' [IASB (1989c)] was issued in April 1989 and replaced the provisions in IAS 3 concerning associated entities which were neither subsidiaries nor joint venture entities of the investor corporation. The treatment of associated entities in the consolidated financial statements raises issues similar to those associated with accounting for subsidiaries. Two methods of accounting for associated entities are recommended in IAS 28 depending upon the circumstances of the associate. The equity method is recommended when the investor corporation can exercise significant influence. In particular IAS 28 (para. 8) states:

The investor accounts for this stewardship by extending the scope of its consolidated financial statements to include its share of results of such associates and so provides an analysis of earnings and investments from which more useful ratios can be calculated. As a result, the application of the equity method provides more informative reporting of net assets and net income of the investor.

The circumstances that allow an investor not to use the equity method to account for an associate are similar to those which allow a parent entity to exclude a subsidiary from consolidation. These are, if the investor entity is holding its investment in the associate for disposal or if there are long term restrictions on the transfer of funds from the associate to the investor. On these points IAS 28 (para. 9) states:

An investment in an associate is accounted for using the cost method when it operates under severe long-term restrictions that impair its ability to transfer funds to the investor. Investments in associates are also accounted for using the cost method when the investment is acquired and held exclusively with a view to its disposal in the near future.

The scope of consolidated financial statements therefore depends on how associated entities are recognised and treated. IAS 28 recommends a number of additional disclosures to assist users in determining the scope of consolidated financial statements. First, IAS 28 (para. 29(a)) requires a listing and description of 'significant

associates' including percentage of ownership interest and proportion of voting power. It is interesting to note that details concerning all associated entities are not required. No information is required to be disclosed concerning those associated entities that are considered 'not significant'. Second, IAS 28 (para. 29(b)) requires disclosure of the method used to account for associates. Third, investments in associates are required to be disclosed separately in the consolidated balance sheet and classified as a long term investment (para. 30). Fourth, the investors share of profits and losses should be disclosed separately in the consolidated income statement (para. 30). Finally, if there are any unusual or prior period items then the investor's share of these is required to be disclosed separately (para. 30).

The above has summarised the main disclosure requirements of IAS 28 in so far as they affect disclosures in consolidated financial statements. IAS 28 became operative for financial statements covering periods beginning on or after January 1, 1990. This is the same operative date as for IAS 27. The consolidated financial statements that have been surveyed in this study have all been prepared during the period that IAS 28 has been operative. A category of items is included in the consolidation disclosure index concerning disclosures of associated entities in consolidated financial statements. The choices provided within IAS 28 provide scope for further diversity in the scope and content of consolidated financial statements.

IAS 31 'Financial Reporting of Interests in Joint Ventures' [IASB (1990b)] applies to entities where an investor has 'joint control'. These entities are distinguished from entities that are subsidiaries, where the investor has 'control'. The treatment and disclosure of interests in joint venture entities affect the scope of consolidated financial statements. IAS 31 (para. 23) states:

When reporting an interest in a jointly controlled entity in consolidated financial statements, it is essential that a venturer reflects the substance and economic reality of the arrangement, rather than the joint venture's

particular structure or form. In a jointly controlled entity, a venturer has control over its share of future economic benefits through its share of the assets and liabilities of the venture. This substance and economic reality is reflected in the consolidated financial statements of the venturer when the venturer reports its interest in the assets, liabilities, income and expenses of the jointly controlled entity by using one of the two reporting formats for proportionate consolidation.

Two formats are recommended. First, combining items in joint venture entities on a line by line basis in the consolidated financial statements (para. 29). Second, separate line items for the venturer's share of assets, liabilities, income and expenses in the consolidated financial statements (para. 29). IAS 31 (para. 42) recommends that proportionate consolidation is the 'benchmark' treatment for reporting joint venture entities in consolidated financial statements using either of the above reporting formats. An 'allowed alternative' is to use equity accounting to report interests in joint venture entities in consolidated financial statements. Each of the above treatments for joint venture entities may be replaced if the interest in the joint venture is held for 'disposal in the near future' or if the joint venture operates under conditions which restrict its ability to transfer funds to the venturer. These circumstances are similar to those which enable subsidiaries to be excluded from consolidation or associated entities to be excluded from equity accounting. If either of these circumstances apply then the interest in the joint venture entity should be reported in the consolidated financial statements at cost. The scope and content of consolidated financial statements will be affected by each of the alternative treatments for joint venture entities discussed above. Therefore, disclosure of the method of accounting used to record interests in joint venture entities needs to be made to ensure users of financial statements are informed concerning their scope.

Other disclosures discussed by IAS 31 concerning interests in joint venture entities are: First, a listing and description of interests in significant joint ventures and the proportion of the ownership of joint venture entities (para. 52). This requirement does

not cover all joint venture entities. The inclusion of details concerning only significant joint venture entities affects the completeness of the information contained in consolidated financial statements. Second, capital commitments of the venturer to the joint venture entity are required to be disclosed separately in the consolidated financial statements (para. 51). Third, contingencies that have arisen or been incurred as a result of the joint venture should be reported separately from other contingencies in the consolidated financial statements of the venturer (para. 50).

The above disclosures concerning interests in joint venture entities affect the scope and content of consolidated financial statements. IAS 31 became operative for financial periods beginning on or after January 1, 1992. The consolidated financial statements surveyed in this study are all from periods when IAS 31 was operative. Therefore, in the consolidation disclosure index a category of items concerning joint venture entities is included. The choices provided within IAS 31 provide further scope for diversity in consolidated financial statement disclosures.

In January 1989 the IASC issued Exposure Draft 32 (E 32) 'Comparability of Financial Statements' [IASC (1989b)] which was the first stage of a project undertaken by the IASC to reduce the choices within IASC standards, and therefore improve the comparability of financial statements. Among the matters covered in E 32 was the elimination of alternative treatments for goodwill and the measurement of minority interests, which were both covered by IASC Standard 22 (IAS 22) 'Accounting for Business Combinations' [IASC (1983)]. In July 1990 the IASC published 'Statement of Intent: Comparability of Financial Statements' [IASC (1990a)] where the following accounting policies concerning goodwill and minority interests were stated. The required or benchmark treatment for positive goodwill was to recognise it as an asset and amortise it to income on a systematic basis over a period not exceeding 5 years unless a longer period could be justified which should not exceed 20 years. Immediate write-off of goodwill to shareholders' equity was no

longer permitted. In the case of negative goodwill the required or benchmark treatment was to allocate it over the nonmonetary assets and if any amount remained after the allocation to treat it as deferred income and recognise it as income on a systematic basis. An allowed alternative was not to make any allocation over the nonmonetary assets but to treat negative goodwill as deferred income and recognise it on a systematic basis in the income statement. Immediately adjusting shareholders' equity for negative goodwill was eliminated as an alternative.

In the case of minority interests two bases of measurement were allowed. The required or benchmark treatment was to measure the minority interest at the pre-acquisition carrying amount. The allowed alternative was to measure minority interest at post-acquisition fair values.

The comparability project of the IASC although restricting some alternatives, still permitted others. In the case of positive goodwill there was scope for variation concerning the method used to amortise goodwill and also the period over which the amortisation was to be carried out. Negative goodwill could be written off to income or allocated over nonmonetary assets. Diversity concerning the treatment of goodwill remains an issue affecting the comparability of consolidated financial statements [Brunovs and Kirsch (1991)]. Minority interests could be measured at either book values or fair values. The result of the above IASC comparability project was that diversity of consolidation accounting practices remained.

During the period that the IASC was reforming its consolidation accounting standards, reforms were also being undertaken by other accounting standard setting bodies and regulatory agencies concerning consolidation accounting. Two of these reforms are outlined below because of their (potential) impact on the IASC and the practice of consolidation accounting in the countries that are the subject of this study.



First, in June 1983 the Council of the European Communities formally adopted the Seventh Directive on Consolidated Accounts [McKinnon and Newham (1984)]. The Seventh Directive introduced the requirement to prepare consolidated accounts on a common basis throughout the member countries of the European Union (EU). The Seventh Directive was descriptive and allowed member countries various choices concerning the way consolidated accounts were prepared and the range and type of information required to be disclosed. The Seventh Directive was introduced into the national laws of EU member countries over the period 1985-1992 [Nobes and Parker (1995, p.138)]. Despite the introduction of the Seventh Directive there remains diversity in consolidation accounting practice in the EU [see for example, Nobes and Parker (1995, pp.325-347), Lefebvre and Lin (1991) and, Radebaugh and Gray (1993, pp.218-9)]. The importance of the accounting harmonisation efforts in the EU is that it represents the most significant attempt to date for a regional grouping of nations to harmonise their consolidation accounting practices. If diversity remains after approximately thirty years of effort directed towards accounting harmonisation in Europe, then this does not augur well for other groups of nations embarking on such a process, as has been mooted for the countries of the Asian-Pacific region [Donleavy (1991)].

Second, in the United States, the issuance of Statement of Financial Accounting Standards (SFAS) No. 94 'Consolidation of All Majority Owned Subsidiaries' [FASB (1987)] broadened the scope of consolidated financial statements. SFAS 94 removed the exclusion of subsidiaries from consolidation on the grounds of having a dissimilar business operation or a foreign location which had been permitted in the United States under the requirements of Accounting Research Bulletin No.51, 'Consolidated Financial Statements' [AICPA (1959)]. The FASB's decision to move to consolidation of all majority owned subsidiaries was designed to enhance the comparability of consolidated financial statements and to cause various techniques of 'off-balance sheet financing' to be included on consolidated balance sheets [Rezaee

(1991, pp.208-210)]. A survey of 142 U.S. corporations' consolidated financial statements for the years 1987 (the year prior to operation SFAS 94) and 1988 (the first year of operation of SFAS 94) concluded that the implementation of SFAS 94 had the following impacts:

- (1) Did not have a material impact on consolidated net income or stockholders' equity;
- (2) did significantly alter the structure and format of financial statements by encouraging the use of unclassified consolidated financial statements;
- (3) did mitigate the problem of 'off-balance-sheet financing';
- (4) did reduce the increasing diversity and inconsistency in consolidation policies and practices;
- (5) caused consolidated companies to appear more leveraged;
- and (6) did improve, although insignificantly, the short-term liquidity of consolidated companies. [Rezaee (1991, p.217)]

The FASB is proceeding with consideration of further reform of consolidated financial statements and issued a Discussion Memorandum which identified numerous financial accounting and reporting issues which concerned the policies and procedures for the preparation of consolidated financial statements [FASB (1991)]. The FASB has published its preliminary views on the following issues: the nature of consolidated financial statements; the meaning of control: restrictions on control; corporations and other entities with similar governing bodies; partnerships and other entities without governing bodies; temporary control; relationships that do not result in control over individual assets; and, control of specific purpose entities [FASB (1994)]. As at November 1995 no definitive statement has been promulgated on any of these issues by the FASB.

The above discussion of the current work of the FASB, which is not a member of the IASC, is important to the present study because of the influences that accounting pronouncements made in the United States have had on countries in the Asian-Pacific region, as well as internationally. The significance of the FASB's Discussion Memorandum on 'Consolidation Policies and Procedures' and other, as yet

unpublished research on other related matters, which is part of the FASB's overall work program, is that the diversity of consolidation practices has been recognised as one of the significant causes of non-comparability of financial statements and is therefore one of the important areas for accounting standard setters to address in the late 1990s [FASB (1991, p.1)].

This Section has documented attempts made since the 1970s to reduce the diversity of consolidation accounting practices. First, the work of the AISG and the IASC was reviewed. In particular, the reduction of consolidation alternatives via the issuance of IAS 27 was discussed. Also, the treatment of associated entities (IAS 28) and joint venture entities (IAS 31) in consolidated financial statements was reviewed. The completion of the 'Comparability Project' which resulted in amendments to IAS 22 concerning the treatment of goodwill and minority interests was examined. However, it was argued there still remained choices in accounting policies and procedures and that the comparability of consolidated financial statements would prove difficult on an international basis. Second, the work of the EU and the implementation of the Seventh Directive in member nations was considered. It was argued despite many years of work endeavouring to achieve harmonisation of consolidated financial statements in the EU diversity remained in the consolidation practices of member nations. The lesson for other groups of nations (such as Asian-Pacific countries) is that harmonisation of consolidation policies is a difficult, and perhaps elusive, task. Third, the recent research conducted by the FASB concerning diversity of consolidation practices and policies was reviewed. The research is important because the FASB has often shown international leadership in accounting standard setting. If the diversity of consolidation practices can be reduced in the United States then perhaps over time the acceptance of reduced alternative practices may gain acceptance in other countries.

## 4.6 SUMMARY

This Chapter has documented the origins and development of consolidation accounting practices. Consolidation accounting was traced to the late Nineteenth Century in the United States and its adoption in the United Kingdom dated from the 1910s. The transfer of consolidation accounting practices to other countries was outlined as a process involving 'change agents' and 'recipients'. In the case of Commonwealth countries the company laws and practices of the United Kingdom provided a model which was readily adopted or introduced by colonial administrators and/or sovereign governments. International accounting firms and the growth of multinational corporations contributed to the widespread adoption of consolidation accounting around the world in the fifty years since the Second World War.

Differences in consolidation accounting practice were traced to alternatives developed in the United States and United Kingdom. It was argued these alternatives arose because of conflicting and confused ideas concerning the nature and function of consolidated financial statements. The assumptions upon which consolidation accounting practice is based were argued to be cultural specific. The adoption of consolidation accounting by countries with non Anglo-American business and cultural environments was argued to be inappropriate and potentially could result in the production of misleading financial statements. The case of Japan and the research of McKinnon (1984 and 1986) was cited as evidence of this point.

Section 4.3 documented a variety of consolidation accounting disclosure and measurement practices. These were grouped into four broad areas.

1. The scope of the consolidated financial statements. Seven sub-areas were discussed under this broad area and each comprises a category in the consolidation disclosure index developed in Chapter 6. These were: Disclosure of accounting

policies, standards and legislation; disclosure of definition of the economic entity; financial statements published; subsidiaries and inter-entity transactions; exclusions from consolidation; associated companies; and, joint ventures and other arrangements.

2. The treatment and disclosure of the outside equity interest in the consolidated financial statements. This broad area is included as one category of items in the consolidation disclosure index developed in Chapter 6.

3. The treatment and disclosure of goodwill in consolidated financial statements. Two categories of items concerning this broad area are included in the consolidation disclosure index developed in Chapter 6.

4. The treatment and disclosure of profits or losses arising on inter-entity transactions. Items concerning this broad area are included in two categories of the consolidation disclosure index developed in Chapter 6.

The relationship between these four broad areas of consolidation accounting practice and the categories in the consolidation disclosure index was summarised in Table 4.1. These alternative practices were argued to contribute to diversity of consolidation accounting disclosures and the non comparability of consolidated financial reports.

Section 4.4 documented the results of ten surveys of international accounting policies and practices. The analysis and discussion focused on reported consolidation accounting practices in the ten countries of the Asian-Pacific region that are the subject of this study. In each survey reviewed the four broad areas identified in Section 4.3 that contributed to diversity in consolidation practice were discussed to the extent that these areas were covered by the survey. The evidence from all these surveys was that diversity in consolidation accounting practices in the ten countries of the Asian-Pacific region which are the subject of this study existed and therefore the comparability of consolidated financial statements of corporations from these countries would be impaired.

Section 4.5 reviewed attempts which have been made to harmonise consolidation accounting practices internationally. In particular the work of the IASC concerning diversity in consolidation accounting practice was examined. The conclusion reached was that despite the issuance of IAS 27, IAS 28, and IAS 31 and the amendment of IAS 22 (the 'comparability project') there remained diversity of consolidation accounting practice among countries in the Asian-Pacific region that have accounting bodies which are members of the IASC. Also the work undertaken by the EU and the FASB concerning respectively the harmonisation of consolidation practices and the elimination of alternative consolidation practices was discussed. It was argued diversity in consolidation accounting practices was one of the main issues confronting both international and national accounting standard setting organisations in the 1990s.

In order to measure the extent of current diversity in consolidation disclosure practices a consolidation disclosure index is developed in Chapter 6. The consolidation disclosure index comprises ten categories of items which are related to the four broad areas of consolidation accounting practice discussed in this Chapter. The relationship between the four broad areas and the categories in the consolidation disclosure index was illustrated in Table 4.1. Hypotheses concerning the association between national cultural values and consolidation disclosure practices measured by the consolidation disclosure index are developed in Chapter 5.

This completes the development of the theoretical framework. First, the general framework for international comparative financial accounting research was outlined in Chapter 2. Then, the relationship between national cultural values, accounting subcultural values and disclosure practices was reviewed in Chapter 3. Finally, in Chapter 4 diversity in consolidation accounting disclosure practices was discussed.