

## **International Trade in Australian Accounting Services and Australian Accounting Firms: State of Play**

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*This paper examines the current involvement of Australian accounting firms in international trade in accounting services. It notes that there has been little empirical investigation into this area which is becoming of increasing importance both to the accounting profession and the Australian economy. It argues that there is an urgent need for empirical studies given the current focus of the WTO in the Doha negotiations and the likely impacts of further liberalisation of trade in accounting services. It also raises questions that would be usefully answered by studies which focus on the issues faced by accounting firms that engage in such trade and the strategies they have put in place to resolve those issues. In this way, academic research can provide information which would facilitate the operations of accounting firms based on more accurate assessments of the potential risks and rewards of engaging in international trade in accounting services.*

### **1. Introduction**

International trade in services has grown rapidly since the changes incorporated in the Uruguay Round and during the more recent Doha negotiations in the World Trade Organisation (WTO). However, there have been few empirical studies of the issues posed for Australian organisations of the growth of international trade in accounting services (McLachlan, Clark & Monday, 2002; Nguyen-Hong, 2000). This is despite explicit Australian Government support for such trade and the recommendations of the recent Mortimer Inquiry into Export Services (DFAT, 2008a; Attorney General's Department, 2008). As a result we have very little detailed understanding of the organisational, managerial and regulatory issues faced by Australian accounting organisations that are planning to import or export accounting services, or which currently offer such services. Yet, if Australian organisations are to maximise their success in exporting or importing accounting services, it is important that the potential issues likely to affect these activities be clearly identified and understood. Accounting firms can then be proactive in addressing and resolving those issues, based on an examination of past and present practices. In addition, educators need such knowledge to suitably

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prepare accounting graduates for practice in an increasingly global economy. Further, if we can determine the extent to which existing models and theories of international trade can be applied to accounting services, this will provide opportunities to incorporate or modify these models to better predict and manage issues likely to affect Australian accounting firms engaged in the provision of these services.

The aim of this paper is to begin the process of facilitating understanding of the issues faced by:

- Identifying the services trade literature relevant to the area;
- Identifying questions which, when answered by empirical research, will enable a more detailed understanding of the issues faced by Australian accounting firms in regard to international trade in accounting services.

The paper is divided into three sections. The first provides a series of definitions of the key concepts used in the paper. The second is contextual in focus, outlining major international and national developments regarding trade in services, with an emphasis on the work of the WTO in relation to accounting services. The third section consists of a literature review and, on that basis, outlines a pilot research project aimed at gaining a more detailed understanding of Australia's role in international trade in accounting services.

## **2. What is International Trade in Accounting Services and Why Should it be Studied?**

The aim of this section is to provide working definitions of what is meant by international trade, services, international trade in services and international trade in accounting services.

### **2.1 What is international trade?**

We define international trade, following common usage, as the exchange of one or more of capital, goods and services across national borders. It includes also all those activities associated with the exchange, although the different activities will be of various degrees of importance, as illustrated in the following case examples.

Case 1. An Australian accounting firm receives a request from a firm based in New Caledonia for assistance in preparing Australian corporate tax documentation. It provides that assistance, thus *exporting* a service to New Caledonia. From the New Caledonian perspective, an accounting service has been *imported*.

## O'Donovan, Carroll & Gibson

Case 2. An Australian accounting firm receives a request from an Australian firm based in Sydney for advice as to its Italian tax obligations in regard to *exports* of goods to Italy and provides that advice. No accounting service has been exported, though the advice has helped in that regard, for the service has not crossed a national border.

Case 3. An Australian accounting firm receives a request from the subsidiary of a firm based in New Caledonia, with which it has had a number of earlier transactions, for assistance in preparing Chinese corporate tax documentation. In order to provide the requested assistance, the Australian firm, in turn, requests advice from a Chinese accounting firm to help it provide that assistance to the New Caledonian firm. In doing so it is both *importing* an accounting service from the Chinese firm and *exporting* advice to the New Caledonian firm.

Case 4: An Australian accounting firm receives a request from a French firm based in New Caledonia for assistance in preparing Chinese corporate tax documentation. It provides advice, for a fee, to the effect that the firm would be best served by gaining more detailed advice from a recommended accounting firm in China. The Chinese and the Australian firm both belong to the same international network of accounting firms, XYZ Inc. The New Caledonian firm accepts the Australian firm's advice and gains its detailed assistance from the Chinese firm. This case identifies four main activities:

1. the Australian firm's initial advice to the French firm is a minor example of the *export* of an accounting service from Australia to New Caledonia;
2. from the New Caledonian perspective, this is an accounting service that has been *imported* to New Caledonia;
3. in later gaining advice from the Chinese firm, further accounting advice has been *imported* to New Caledonia, not from Australia, but from another country, China;
4. by virtue of their membership of the XYZ network, both the Australian and Chinese firms have *imported* an accounting service to Australia and China, respectively, although not specifically in relation to this transaction. The service imported is their right of access to information about the members of the network of accounting firms that might be of commercial value. If we assume that the Australian firm learnt about the Chinese firm by reference to XYZ's membership directory, then both will have gained from that service in this particular case, with the fee for service being their membership of the XYZ network.

Case 5: An Australian accounting firm decides to contract out, or outsource, its tax return work to an Indian accounting firm, thus *importing* a service from India (from the Indian perspective a service has been *exported*).

## O'Donovan, Carroll & Gibson

Case 6: An Indian accounting firm decides to offer tax return services to Australian clients from its base in Bangalore, advertising their availability on the web and in various trade directories. If its offer is accepted by an Australian firm, it is *exporting* an accounting service and the Australian firm is *importing* a service.

Case 7: An Indian Accounting firm B decides to engage an Australian accounting firm to provide advice in regard to its Australian clients. It is *importing* an accounting service and Australia is *exporting* that service.

Case 8: An Australian, a British, a Chinese, an Indian, an American and a French firm, all members of the XYZ international network, each audit a subsidiary of global firm 'Atlas', based in each of their countries, for a Canadian accounting firm, acting on behalf of Atlas, which is domiciled in the Cayman Islands. The Canadian firm reviews each audit and combines them into a global audit report, which is submitted to Atlas. In the Australian, British, Chinese, Indian, American and French cases the audits are examples of the *export* of accounting services to the Canadian firm, and an import of services by the Canadian firm. The latter, in turn, *exports* its services, the report, to Atlas in the Cayman Islands, in which it is regarded as an *imported* accounting service.

### 2.2 What is a service?

It is not the intent of this section to enter into the debate that has been in progress for several decades about how to define services, although we acknowledge that it is a contested area in which a wide range of definitions has been developed (see, for example, Cook, Goh & Chung, 1999; Edvardsson, Gustafsson & Roos, 2005). We find the definition offered by Gronroos to be the most useful for the purposes of this study:

“...an activity or series of activities of a more or less intangible nature that normally, but not necessarily, take place in the interaction between the customer and service employees and/or physical resources or goods and/or systems of the service provider, which are provided as solutions to customer problems.” (Gronroos, 2001)

Further, following Lovelock and Yip (1996), three major categories of services can be distinguished. These are: people-processing services that involve tangible actions to customers in person; possession-processing services involving tangible actions to physical objects so as to improve their value to customers; and information-based services that depend on the collection, manipulation, interpretation and transmittal of data to create value, as is the case for trade in accounting services.

### 2.3 What is an accounting service?

A useful definition of accounting is that offered by a committee of the American Accounting Association, which defines it as:

“...the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information.” (Carnegie, Jones, Norris, Wigg & Williams, 1999)

Hence, an accounting service consists of the activity or activities involved in the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information. It should be noted that this definition potentially excludes several of the services, or aspects of the services offered by accounting firms, including business advice and consulting, and IT consulting, unless those services involve one or more of the identification, measuring and communicating of economic information.

In practice it is difficult to differentiate services that have no financial dimension from those that do, as, at least in the case of business firms, virtually all of the services provided might have a financial dimension. The services that fall into the category of accounting services can be identified as:

- Audits and assurance, including internal audit and IT audits;
- Due diligence and business acquisitions;
- Investigative and forensic accounting;
- Reviews of compliance with Australian International Financial Reporting Standards (IFRS);
- Adequacy of budget and forecasting processes;
- Taxation, including corporate, business and personal taxation consulting and compliance, advice on international transactions, indirect taxes, specialist tax needs;
- Business recovery and insolvency;
- Corporate transactions, including capital raisings, initial public offerings, mergers and acquisitions, restructuring;
- Valuations;
- Litigation Support;
- IT consulting where that involves the development, sale, operation of, or advice about software systems for accounting purposes;
- Annual financial statements and compliance;
- Equity and debt raising;
- Personal investment services, including portfolio management;
- Superannuation consulting and compliance services, including self managed funds and retirement planning;
- Succession and estate planning;

## O'Donovan, Carroll & Gibson

- Financial planning, including cash flow management, asset protection and insurance;
- Risk assessment and management;
- Networking advice and functions;
- Training and educational services.

This broad range of services provided by accountants, all with the potential to be traded internationally, indicates the extent of potential issues that may need to be addressed, or at least considered, by accounting firms.

### **2.4 What is international trade in accounting services?**

International trade in accounting services consists of that activity or activities involved in the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of the information. It includes the specific services noted above. The provision of that advice involves interactions between the customer and firm concerning the exchange of one or more of capital, goods and services across national borders. A useful list of the major modes of supply of such services is provided by the WTO (WTO, 1998a).

All of the above services involve, to varying extents, the supply of the service in question by physical or virtual meetings, or both, of the producer and consumer of the services. Until recently such services involved a greater degree of movement across national borders by either or both of the producer and consumer, but this has been markedly lessened by the development of modern telecommunications and the Internet. The latter involves what is often referred to as 'virtual' movement, but not physical. The WTO recognises four broad modes of supply or delivery, and an accounting firm may use any one or more of the modes. The modes are:

Mode 1: Cross-border supply is defined to cover services flows from the territory of one member into the territory of another member, though the supplier and consumer do not meet (e.g. accounting services transmitted via telecommunications or mail);

Mode 2: Consumption abroad refers to situations where a service consumer (e.g. a manager or owner) moves into another country to obtain a service. In essence, the client travels, either to Australia to receive the service in question, or to another foreign country in which the Australian firm provides it;

Mode 3: Commercial presence which implies that a service supplier in one country establishes a territorial presence, including through ownership or lease of premises, in another country to provide a service (e.g. local 'branches' of the large accounting firms and networks), either by a presence in cooperation with an

## O'Donovan, Carroll & Gibson

existing legal entity in one or more of the countries concerned, or by establishing a separate legal entity; and,

Mode 4: Presence of natural persons consists of persons of one country entering another country to supply a service, though only on a temporary basis (WTO, 2008a). In other words, a member of an accounting practice might travel overseas *temporarily* to the country in which the client is established to consult or work with them.

### 3. Context: Recent Developments in Trade in Services

As noted by the WTO, the global value of trade in commercial services increased by 18 percent in 2007, faster than the rate of 15 percent for trade in goods (WTO, 2008b:p6). The major exporters of services are the European Union, the USA, Japan, China and India, with the exports of business and professional services by China and India having increased much faster than the world average in recent years (WTO, 2008b:p6). Australia ranks 24th as an exporter (1.2% or US\$39 billion), and 22nd as an importer (1.2% or US\$38.2 billion). The bulk of Australia's services export trade is with, in order, the European Union (EU), United States (US), China, Japan and New Zealand, with exports to China growing most rapidly. The bulk of its services import trade is, in order, with the U, US, Singapore, New Zealand and Japan, with imports from Singapore growing most rapidly (WTO, 2008b).

The Australian Government values Australia's two-way trade in services on a different basis than the WTO, to a total of AUD\$90.6 billion in 2006-07, with exports of services valued at AUD\$46.2 billion, or 21 percent of total exports. Imports of services were \$43.4 billion, or 19 percent of total imports (DFAT, 2007:p24). However measured, the figures represent a substantial change since the 1960s, when Australian services exports and imports consisted mainly of transportation services related to merchandise trade, which accounted for 70 percent of exports and 66 percent of imports of services. Since 1980, in particular, Australia has experienced a rapid average annual growth in new services of 17 percent, notably in tourism, education and business and professional services, with transportation now amounting to only 19 percent of services exports, an average annual growth of 17 percent (ABS, 2007).

Within the above context, Australian exports of accounting, auditing, bookkeeping and tax consulting services rose from AUD\$185 million in 2004-05, to AUD\$366 million in 2006-07, a rise of 90 percent for the period. Imports of the same services in the same period rose from AUD\$102 million to AUD\$258 million, a rise of 73 percent. Exports of business and management consulting and public relations rose from AUD\$76 million to AUD\$247 million in the same period. Imports of those services rose from AUD\$48 to AUD\$121 million, or 116 percent in the same period (ABS, 2007). Hence, while the value of trade in accounting services is relatively small compared to education services, it has grown rapidly

in importance and there is potential for further growth as the economies of the Asia-Pacific region develop. The effects of the global financial crisis from late 2008, however, have provided a catalyst for some companies to review and re-examine their processes, and a panel of experts was recently formed to consider previous mistakes and the likely future for these activities (O'Connor, 2010).

### 3.1 Policy and regulatory developments regarding trade in services

As the importance of international trade in services has grown it is not surprising that governments, supranational organisations and business and professional bodies have become increasingly interested in the implications of that growth and its national and international impact. The bulk of this interest has been focused on the work of the WTO, as the primary source of international developments relating to trade in services. Within the WTO context it was the US that pushed hardest in regard to the importance of trade in services and the need to remove barriers to that trade. Its interest in services sprang, for the most part, out of the balance of payments deficits it began to experience from 1971. It attempted to deal with these deficits by promoting trade liberalisation in areas in which its economy was most competitive and in the 1970s it was experiencing substantial surpluses in its services trade (Feketekuty, 1988:p299-309). The strength of US interest in trade in services can be seen in its threat to abandon the GATT if services trade was not placed on the negotiating table during the Uruguay Round of Multilateral Trade Negotiations (Lapid, 2005:p.16).

The most important outcome of the Uruguay Round from the perspective of trade in professional services was the General Agreement on Trade in Services (GATS). Its goal was to open up trade in services of nearly all kinds between WTO members, largely by the gradual elimination of regulatory barriers, the guarantee of access to national markets and, importantly, by exercising various 'disciplines', on members that breach the agreement (WTO, 2008a). However, while GATS was regarded as a breakthrough in relation to services, with members signing up to a number of general obligations that applied to all sectors, most members did not, nor have not, greatly expanded their commitments to remove barriers to services trade. The key general obligations signed up to were:

- Most Favoured Nation Treatment;
- The publication by each member of all relevant legislation, regulation, policies and procedures;
- The establishment of national enquiry points mandated to respond to other Member's information requests;
- An administrative review and appeals procedure, together with disciplines on the operation of monopolies and exclusive suppliers. (WTO, 2008a)

In addition, and importantly, individual members can voluntarily commit themselves to a range of further measures aimed at freeing up trade in services,



## O'Donovan, Carroll & Gibson

including accounting services. As a result there is considerable variation in the extent to which individual members have committed themselves to further measures, with many restrictive measures remaining in place as members realise that, once committed, those measures become binding. The currently stalled Doha Round of negotiations between WTO members (it was originally planned to conclude in 2005), is aimed at expanding members' commitments by eliminating various restrictive measures.

What makes the Doha round of great significance for trade in accounting services is that the WTO has selected accounting services to be the test case for applying Article VI: 4 regarding domestic regulation in member countries (WTO, 1998b). This article, if agreed to by members, will empower the WTO to develop and implement 'disciplines', aimed at ensuring that nationally-based, domestic regulations related to licensing, qualification requirements and technical standards do not constitute unnecessary barriers to trade in accounting services. The choice of accounting services is likely to have been based on the fact of the early internationalisation of accounting firms and, in turn, of accounting standards. If successful, the 'accounting model' will then provide the future template for extending Article VI to other professions and trades. As might be expected, the proposed application of Article VI: 4 is controversial and no substantial progress has been made in gaining agreement among WTO members.

Australia's initial, 2001 negotiating position in the Doha Round noted that those of its exporters involved in accounting services had identified impediments to further liberalisation of the accountancy sector in the form of restrictions on establishing a commercial presence or foreign equity limitations in some markets including:

- unduly onerous and/or non-transparent temporary visa procedures;
- citizenship or residency requirements for licensing or certification;
- limited or no recognition of qualifications or unreasonable requirements for qualifying examinations;
- restrictions on the use of firm names;
- restrictions on electronic transmission of reports and accounting documents.

This initial Australian offer was revised in 2005, but remains substantially the same in intent (WTO, 2005). If successful, the Australian proposals are aimed, as key priorities, at helping to open up key markets for Australian firms in its immediate region, including the ASEAN countries (Indonesia, Malaysia, Philippines and Thailand), Japan, Korea, China, Chinese Taipei and India (DFAT, 2008a, 2008b).

In summary, the rapid growth of international trade in services in recent decades has stimulated greater interest by accounting firms, professional bodies, governments and international organisations. It has led to international trade in

accounting services coming to the forefront of international attention in the WTO. If we assume that the current Doha round of negotiations succeeds in further opening domestic markets for accounting services to greater international competition, then Australian accounting firms will be faced with both a growing competitive threat and a significant opportunity. Yet little is known about the current extent of Australian trade in accounting services, or its capacity to either meet this threat or to benefit from the opportunity further trade liberalisation offers.

### **4. Australia: State of Play**

#### **4.2 Demographics**

There are limited academic studies which provide information on various aspects of trade in services. A recent survey from the Max Planck Institute, for example, found that finance and accounting services account for 11.7 percent of services obtained offshore (O'Connor, 2010). But a holistic view of the extent of both imports and exports is not provided, and at present there is almost no Australian data regarding Australian entities engaged in international trade in accounting services, nor is there any great wealth of data available regarding those providing accounting services, whether or not they engage in international trade. The little that is available has been published for the most part by government bodies (see, for example, ABS, 2003, 2007).

#### **4.2 The non-international trading organisation**

The limited available evidence shows that most firms do not engage in international trade in accounting services, in common with the general tendency of firms, whether engaged in manufacturing or services (Miesenbock, 1988; Ford & Leonidou, 1991; Westhead, 1995; McDougall & Oviatt, 1996; Havnes *et al.*, 1998; Prince & van Dijken, 1998). The sole study we have found that relates to accounting firms suggests that there are a number of differences between those accounting firms that internationalise and those that do not (Baggchi-Sen & Keuchler, 2000). That study was limited to small and medium size accounting firms in upper New York State, a region close to the Canadian border and Toronto. It found that nine of its sample of forty three had successfully internationalized, with nineteen others interested in internationalization (Baggchi-Sen, Kuechler, 2000:p131). The average, internationalised firm typically was larger, employing on average 25 staff on a full time basis, with four owners and a greater range of staff expertise. No sole proprietorship characterised itself as internationalized. The internationalized firms earned 37.22 percent of revenue from audit and 17.44 percent from management advisory services. In contrast, the non-internationalised firms earned 16.08 per cent and 21.05 percent from audits and 7.12 percent and 11.74 percent respectively from management advisory services (Baggchi-Sen & Kuechler, 2000:p131).

## **O'Donovan, Carroll & Gibson**

This raises questions including whether or not these propensities hold true for Australian accounting firms. To answer this would require comparisons of accounting firms not engaged in international trade with those that are engaged in order to gain an appreciation of the determinants of such differing propensities.

### **4.3 Market entry modes and the entry decision**

The academic literature in relation to international market entry is large and suggests a number of interesting questions for research (see Canabal & White, 2008; Lommelen & Matthyssens, 2004). The first is that the bulk of the literature tends to either assume that firms make a rational market entry choice based on systematic evidence as to the costs and benefits involved, or to use rational choice type frameworks in assessing actual practice. While the former might be the case it is an assumption rarely tested in the literature and not tested, as far as we can determine, in regard to accounting services (Hohenthal, 2002; Mangos, Roffey & Stevens, 1995). An investigation into the validity of this view would analyse the processes and methods involved in accounting firms' decisions to engage in international trade in accounting services.

The second area concerns the reasons for entering international trade, which are many and various, as are the studies of them, which suffer from a variety of limitations (Zhao, Luo & Suh, 2004). It is important to identify whether those entering trade in accounting services do so for similar or differing reasons than those suggested in the literature. Thus it would be relevant to ask an appropriate sample of accounting firms what their reasons were for engaging in the import or export of accounting services, and identify the type of service provided.

The third area is related to the fact that the bulk of the market entry literature focuses upon market entry modes for manufactured goods rather than services, though there has been an increase in the literature related to service firms (see Canabal & White, 2008; Sanchez-Peinado, Pla-Barber & Hébert, 2007). However, even within the services entry mode literature, we have been able to find only a very few that examined international market entry modes for accounting firms, usually involving small numbers in a larger sample of service firms (see, for example, Blomstermo, Deo Sharma & Sallis, 2006). It would be useful to investigate the entry modes selected by accounting firms, by service provided, and compare them with other service industries and manufacturing firms. Key questions would ascertain which entry mode the firm selected for engaging in trade in accounting services, and what were their reasons for selecting each entry mode for the different services.

### **4.4 Organisational design**

International market entry can have a significant impact on the organisation of a firm, for example, where the outsourcing or sub-contracting of an existing activity or service is involved, such as the increasing international outsourcing of tax

return work to Indian firms by US firms (Konrad, 2007). Where an intra-firm unit previously undertook such work then it might be terminated, or its function might change to one of monitoring the quality of the outsourced work. Similarly, where the entry mode decision is to establish an offshore subsidiary the organisation of the parent is made more complex, especially where local regulations require the subsidiary's establishment in a legal form with which the parent is not familiar. Several authors have argued that internationalisation has already resulted in significant organisational changes in professional service firms (Brock, 2006; Malhotra, Morris & Hinings, 2006). The gathering of further empirical evidence of specific organisational changes required would provide useful guidance for new entrants. Whether expectations were realised following entry to the new market is also a very fertile area for future research.

### **4.5 Market exit**

There have been relatively few studies of international market exit and none that the authors have identified that examine exit by accounting firms (Matthyssens & Pauwels, 2000; Decker & Mellewigt, 2007). Three basic questions are raised in relation to this: what causes international market exit; what, if any, are the barriers to exit; and what are the results of exit on the firm's continuing operations? It is important to identify whether or not there are long term effects on firms which exit the market that could have been avoided through better-informed preparation for entry with a more complete understanding of likely issues to be encountered.

## **5. Conclusion**

The aim of this paper was to argue that we know surprisingly little about the range of issues faced by accounting firms in relation to international trade in accounting services.

Whilst international trade in services is now an integral part of global business, it is often superficially portrayed as a seemingly simple cost-cutting exercise. The reality, however, is that setting up and monitoring the complex mechanisms required to establish, manage, monitor, and assess the services provided and received can be difficult and costly, and may involve a great deal of risk.

There is a clear opportunity for further research to identify the potential pitfalls to be avoided, as well as potential opportunities. The three most common areas of accounting currently outsourced are accounts payable, bank and other reconciliations, and asset accounting management (O'Connor, 2010), and this leaves broad areas of opportunity still available. Reliable, evidence-based advice could minimise the risk to Australian accounting firms, and form a practical basis for facilitating the expansion of Australia's involvement in international trade in accounting services.

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## O'Donovan, Carroll & Gibson

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## O'Donovan, Carroll & Gibson

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