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Fiscal year-end choice: determinants and dynamics☆

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Abstract

The international diversity of firms' fiscal year-end is relatively unknown. However, this diversity has practical implications for both accounting research and business comparability. In this study, we examine the backgrounds of the diversity. We found that differences in tiny, supposedly unimportant details in national legislation on fiscal year-end have a much stronger impact on fiscal year-end choice than the generally assumed cause of seasonality. In the last decade of international harmonization, we found only a few instances of fiscal year-end changes motivated by enhancing comparability. Worldwide, a weak drift towards December was found.

Keywords: Fiscal year-end choice; International diversity; Comparability

1. Introduction

The choice of fiscal year-end seems straightforward. The obvious balance sheet date seems to be December 31. In the literature, little attention is paid to it. Two of the few relevant studies are Huberman and Kandel (1989) and Smith and Pourciau (1988). They examined whether December and non-December firms differ systematically in characteristics such as size and industry. They argue that researchers often restrict their sample selection to either December or non-December firms. Generalizability in empirical financial accounting research may therefore be affected by the presence of systematic differences between December and non-December year-end companies.

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However, these studies do not address the causes of the international diversity in fiscal year-end. It could be argued that since, both in practice and in the literature, little attention is paid to the choice of fiscal year-end, this does not matter. However, both diversity and uniformity in fiscal year-end have advantages and disadvantages in several areas.

The most prominent argument for a uniform fiscal year-end is comparability. When comparing the financial performance of two firms with different fiscal year-ends, significant changes in the business environment in the nonoverlapping period may hamper comparability. In addition, when two firms merge, they have to align their annual reporting. This results in short or long fiscal years, which hampers time series analysis.

On the other hand, diversity in the fiscal year-end provides a far more continuous flow of economic business data. This would be beneficial for economic policy makers who can react faster on recognized trends. In addition, external auditors could spread their workload better over the entire year. This may reduce costs. In fact, there are auditing firms that offer discounts to clients who close their books outside the "busy" season. In this study, we will address the causes of international diversity in fiscal year-end, based on an analysis of differences in the national legal environment of firms and large samples from databases such as Global Vantage. The samples will also be analyzed to explore whether changes in fiscal year-end tend to harmonize towards an international uniformity.

2. Causes of fiscal year-end diversity

The best known explanation of non-December fiscal year-ends is the seasonal pattern of a firm's business. The argument is that the fiscal year should end at the natural business cycle of a firm. On the other hand, the choice of fiscal year-end may be determined by accounting or fiscal legislation or customs in the industry or country. In many countries, firms are free to choose the fiscal year-end they prefer. However, small differences in the way legislation is stated may lead to large differences in practice when firms do not have a strong preference for a particular balance sheet date. These small differences in legislation are illustrated by the various approaches in continental Europe, the UK, and the US. In most continental European countries in the European Union, the law assumes the balance sheet date to be December 31, unless the Articles of Association say otherwise. Therefore, if continental European firms do not have an explicit preference, the balance sheet date will be December 31. The Companies Act 1985 (Sections 223 to 224) in the UK states that the first fiscal year normally ends the last day of the month in which the anniversary of its incorporation falls. If the company was incorporated before April 1, 1985, the Companies Act 1985 determines the fiscal year-end to be March 31. All companies are allowed to alter their fiscal year-end (Companies Act 1985 section 225.) Therefore, if British firms do not have an explicit preference, balance sheet dates will be scattered quite randomly over the calendar year, following the (coincidental) founding date, with a skewness in March due to "older" companies. In many US states, legislation requires that the Articles of Association explicitly mention the freely chosen balance sheet date. Therefore, founders of the firm are forced to pay attention to this choice. They may select either the calendar year, the end of the business season, or the founding date.

Thus, we also expect a diverse choice of fiscal year-ends for US firms. Finally, for some countries, the fiscal year-end may be influenced by tax law. If tax law prescribes a certain balance sheet date, the firm is likely to align its financial reporting to the tax period. However, in most countries, the tax period follows the choice made for statutory accounts. In order to examine whether balance dates are associated with national legislation or industry, we selected data from Datastream. The fiscal year-ends of 14,896 listed firms as per September 1999 were retrieved, sorted by country. The largest subset was of US firms (8744). For Canada, the UK, and Japan, more than 1000 firms per country were selected. For most of the remaining countries, the number of firms ranged between 200 and 750. The distribution of the fiscal year-end per country is presented in Table 1.

Table 1 shows that there are indeed international differences in the "popularity" of certain balance sheet dates. Continental European firms have a strong preference for December, with percentages for December about 90%. For the UK, fiscal year-ends are far more spread over the year. Only 39% of the firms chose December. A similar pattern is found for the US and Canada, although to a more limited extent. Japanese firms have a strong preference for March, and the South Pacific countries, Australia, and New Zealand, often choose the end of June. The patterns of continental Europe and the UK support the conclusion that fiscal year-end choice is primarily based on the date suggested by national legislation. Apparently, firms do not often attempt to enhance comparability by choosing a uniform balance sheet date. The relative high uniformity in continental Europe is a simple effect of legislation. If a different date is suggested, like in the UK, the pattern changes drastically, and no uniformity occurs. Australia has a mandatory tax period ending June 30. Most Australian firms appear to align their annual reporting to this mandatory tax period. In New Zealand, a distinction can be made between private and public companies. According to a public accountant from New Zealand (oral communication), "New Zealand's traditional balance date for most individuals and private companies is 31 March. Most public companies have adopted June 30 to coincide

Table 1
Distribution of fiscal year-ends per country, in percentages

	January	February	March	April	May	June	July	August	September	October	November	December
France	0	1	3	0	0	1	0	1	2	1	0	91
Germany	0	0	2	0	0	5	0	0	10	2	0	78
Italy	0	0	0	0	0	2	0	0	0	0	0	98
Switzerland	0	2	1	0	0	1	0	0	4	0	0	91
Belgium	4	0	2	0	0	2	0	0	0	0	0	92
Netherlands	4	0	4	1	0	0	1	0	3	0	1	88
UK	3	3	22	5	4	7	2	3	9	2	1	39
US	4	1	6	2	2	9	2	2	7	2	1	62
Canada	5	2	7	2	3	4	3	5	6	3	2	60
Japan	1	5	84	0	1	0	0	0	1	1	1	6
Korea	0	0	13	0	0	5	0	0	3	0	1	78
Australia	0	0	3	0	1	74	5	1	2	0	0	14
New Zealand	0	1	21	0	4	43	4	6	7	1	0	13

with Australia. There is no other logic to it." Within Japanese standard setting, the national government has the most significant influence on accounting, based on an implicit and persistent belief that accounting should eventually contribute to the development of the national economy as a whole (Walton, Haller, & Raffournier, 1998) For this purpose, alignment to the government's accounting period, which (traditionally) ends on March 31, is important. The results show that Japanese firms indeed follow the government's accounting period.

3. Association between fiscal year-end and industry

Although the findings of the previous section suggest that the choice of fiscal year-end is mainly driven by national legislation, for some industries, the impact of seasonality may be stronger. Note that this argument only applies for those industries that have a seasonal business pattern. Therefore, we focus on department stores and clothing retail, the best known industry with a typical seasonality, ending in the first months of the calendar year. From Global Vantage, we selected all available firms in this industry from the US, the UK, and continental Europe as per December 1999, and compared the relative distribution of fiscal year-ends. The results are presented in Table 2.

Table 2 shows that the skewness in the first 3 months of the calendar year is the highest in the US, while in Europe, the distribution is very similar to the average distribution of fiscal year-ends of European firms. This suggests that in the US the fiscal year-end choice is more strongly based on business characteristics, while in Europe, seasonality plays a minor role in determining the fiscal year-end. Given the scope of Global Vantage, the focus is here on large listed firms in one industry, so results may not be generalizable to smaller firms in other industries. However, in the total data set, we did not find major industries with a stronger skewness. Therefore, in some industries, the seasonal effect may be stronger, but this has a low impact on general practice. Also, large firms are often more diversified than small

Table 2
International comparison of fiscal year-end in department store and clothing industry (percentage)

	US ($n=114$)	UK ($n=43$)	Continental Europe ($n=64$)
January	39	28	8
February	3	5	0
March	1	16	3
April	2	7	–
May	2	7	–
June	3	–	–
July	3	–	–
August	1	5	–
September	3	2	–
October	3	7	5
November	1	2	–
December	47	21	84

companies, which may neutralize the seasonality, if any, of individual segments on a consolidated basis. Thus, small, nondiversified firms may have a stronger incentive to choose a non-December fiscal year-end. We used the Dutch database, Elsevier's Financieel Economisch Lexicon Top 5000, to expand the analysis to smaller firms. The database contains the financial data of the top 5000 Dutch firms. Since the Dutch economy is relatively small, its top 5000 comprises relatively small companies. When stratified on sales, we did not find a significant change in the distribution of non-December firms. This suggests that size does not affect the fiscal year-end choice.

4. Fiscal year-end changes

So far, we showed that fiscal year-ends differ significantly internationally. In this section, we examine whether international accounting harmonization causes a drift in fiscal year-end towards a worldwide equilibrium by analyzing patterns in fiscal year-end changes. Note that harmonization of fiscal year-ends does not follow directly from International Accounting Standards (IAS), since IAS do not elaborate on the choice of fiscal year-end. Therefore, a harmonization of fiscal year-end would be driven by forces other than explicit standards. Firms may change their fiscal year-ends for various reasons. They may decide to switch from their founding date-based fiscal year-end to a date that reconciles to their business seasonality, or in the case of a merger, they may align with the balance sheet date of the firm with which they have merged. Firms may also align their fiscal year-end with the common fiscal year-end in their industry, in order to enhance the comparability of the financial statements. The latter argument coincides with the aim of (international) accounting harmonization. From the total set of the 13,503 available firms in Global Vantage, we selected all firms that changed their fiscal year-end between 1990 and 1998. This resulted in a subset of 756 firms, implying that in the 10 year period studied, 5.6% of the selected firms had a fiscal year-end change, i.e., a half percent annually on average. There is a relatively high incidence of fiscal year-end changes in the UK, the US, and Canada (0.9% annually). These are also the countries with a relatively high variance in the distribution of fiscal year-ends. Relatively low incidences of fiscal year-end changes occur in Japan (0.22%) and France (0.33%). The less stable choice of fiscal year-ends in the UK and the US raises the question of whether the changes in fiscal year-end are subject to a trend. We constructed migration matrices for the individual countries. The migration matrix summarizes all fiscal year-end changes "from" (e.g., the original fiscal year-end) to "to" (the newly chosen fiscal year-end). Since most of the fiscal year-end changes (72%) relate to December (either the original fiscal year-end or the newly chosen fiscal year-end), we focus on those fiscal year-ends only. The results are presented in Table 3. For example, the upper left cell in Table 3 shows that six US firms changed their fiscal year-end from January to December; the upper right cell says that in the total data set, 14 firms changed their fiscal year-end from December to January.

On the bottom line of Table 3, the trend is quantified by dividing the total number of firms that changed their fiscal year-end to December by the total number of firms that changed their fiscal year-end from December to another month. For example, in the US, the number of firms

Table 3
Fiscal year-end changes from and to December

	US		UK		Germany and France		World	
	To	From	To	From	To	From	To	From
January	6	5	3	4		1	18	14
February	9	1	4	3			20	6
March	22	7	14	6	1	5	81	45
April	13		2	1		1	28	2
May	5	3	10				11	3
June	35	3		4	5	10	90	34
July	5		1	2	1		11	4
August	9	1	1			1	22	4
September	22	19	12	3	10	9	67	38
October	5	3	8	1		2	17	9
November	6	1			1	1	11	7
Total	137	43	55	24	18	30	376	166
Ratio towards December	3.2		2.3		0.6		2.3	

that adopted December as the new fiscal year-end is more than three times (3.2) the number of firms that traded their December year-end for another month. Again, we see contrary trends between US and UK and between Germany and France. In the US and UK, the net effect of fiscal year-end changes is in favor of December. In Germany and France, the popularity of December slightly deteriorates. The relatively large portion of US and UK firms in the data set is the reason for the 2.3 ratio towards December on a worldwide basis. Note, however, that since the average rate of change is only a half percent annually, significant changes in distributions of fiscal year-ends require many years. The resemblance of the current distributions with those in earlier research (see Foster, 1986) confirms this slow rate of change. To explore the underlying reasons for the change in fiscal year-end for 50 US firms in the subset, the financial statements of the year of change were retrieved from the EDGAR database. The notes to the financial statements were reviewed to find the reason management gave for the change in fiscal year-end. In 29 cases, the change in fiscal year was mentioned and reasons were provided. In only four instances was the change of fiscal year-end made explicitly to align the fiscal year-end with the industry, in order to enhance comparability. In other cases, the change of fiscal year-end followed a merger or a major acquisition (eight instances) or aligned the fiscal year-end with the seasonal business pattern (five instances). The remaining four instances were diverse in nature. These findings suggest that enhancement of comparability within the industry explains only a limited number of fiscal year-end changes.

5. Summary and conclusions

The choice of fiscal year-end does not attract much attention in either accounting research or in practice. This paper shows that there is a great diversity internationally in fiscal year-

ends. In this paper, we focused on two determinants of the choice of the fiscal year-end, national legislation, and seasonality. We retrieved large samples from public financial databases. Although, in most countries, firms are free to choose any fiscal year-end, company laws often provide guidance if the firm does not have a particular preference.

In the analysis of the association with industry, we found a stronger non-December effect for department stores and clothing retail only, although, even for this industry, the impact of legislation was very clear. In the period 1990–1998, some 0.5% annually of firms worldwide changed their fiscal year-end. Only a small part of these changes was explicitly imposed by the desire for comparability. The fiscal year-end changes have a ''mean reverting'' drift: Anglo-Saxon firms tend to adopt a December fiscal year-end, and continental European firms tend to change their December fiscal year-end to a non-December book year. Since fiscal year-end changes occur relatively infrequently, it appears that international diversity will remain for a long period. Since legislation on fiscal year-end appears to be merely a matter of (coincidental) choice, it is worthwhile to rethink whether it would be relevant to pursue international harmonization of the fiscal year-end. Individual firms should weigh the benefits of comparability and auditor costs relating to either December or non-December fiscal year-end.

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