

**The International Handbook of
Financial Reporting 2nd ed**

THE INTERNATIONAL HANDBOOK OF FINANCIAL REPORTING

SECOND EDITION



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Preface

This guide has been prepared to give a brief description and explanation of the accounting and reporting practices in selected countries. Its layout, by country and then by subject matter, is intended to:

- Portray the financial reporting procedures in each country; and
- Facilitate the comparison of the procedures by using, for the most part, the same subject headings for each country selected.

Since the publication of the first edition of this book in 1993, the main development in international financial reporting has been the move towards further international harmonisation of accounting standards. This has been driven, largely, by the agreement between the International Accounting Standards Committee (IASC) and the International Organisation of Securities Commissions (IOSCO) in 1995. The IASC is working hard to produce a core set of standards, and more details are given in the chapter on International Standards and Guidelines. However, countries around the world have differing attitudes to the use of international accounting standards, and differing attitudes to the attempt to harmonise standards around the world. In this second edition, the opportunity has been taken to provide information on these different attitudes in different countries.

Although this book covers many of the important matters to be considered in looking at financial statements, it is not intended to be a comprehensive survey of all differences in accounting methods among countries. It aims to provide general guidance and does not seek to provide answers to all the questions that may arise in any given situation.

The financial statements of un-incorporated business concerns such as partnerships are not dealt with specifically, though many of the accounting principles and practices described in each chapter will be relevant to them.

Whilst all reasonable care has been taken in the preparation of this book no responsibility or liability is accepted by the authors for any omissions or misstatements it may contain or for any loss or damage howsoever occasioned to

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any person relying on any statement or omission in this book. Professional advice should be sought before any decisions are taken.

The scope of experience reflected in this book is the result of time, effort, and co-operation from many partners and staff of Nexia International which is an organisation with 300 offices in more than 75 countries employing over 7,500 individuals. Member firms provide clients with a comprehensive range of accounting, auditing, tax and consultancy services on both a national and international basis.

Should further information or advice be required whether generally or on specific issues raised in this book, readers should contact their local Nexia Contact partner (a full list is given at the back of this book), or write to:

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Introduction

Objectives

Those faced with the task of understanding a set of foreign financial statements will naturally tend to base their judgement on their knowledge and experience of the way in which financial statements are prepared in their own country. It can, however, be very misleading to attempt to apply this knowledge and experience to financial statements prepared in another country without first having a basic understanding of the accounting and reporting practices of that country.

Financial statements are produced in response to the varying needs of users. The answers to the questions - "Whom are they meant for?" and "What do those people need them for?" and other related questions - have shaped the development of accounting and reporting practices worldwide. There are various factors that help provide the background against which a company's financial statements can be viewed:

- What class of users are the financial statements intended for? Does the government's need for accounting information take precedence over that of investors/creditors? How active is the capital market/stock exchange? Are users more interested in performance and profitability or balance sheet strength?
- How much emphasis is placed on creditor protection and conservatism? Is the prudence concept tempered by the need for fair presentation or is heavy conservatism applied in valuing assets and making provisions?
- To what extent does the company dictate the form of the financial statements? Are the detailed requirements formulated by the accounting profession or by law? How good is the general quality of financial statement disclosure? Requirements established largely by the professional bodies are usually published in the form of "Accounting Standards". For example, in the United States there are virtually no legal requirements but the pronouncements of the Financial Accounting Standards Board (FASB) are binding for companies producing financial statements that are prepared in accordance with generally accepted accounting principles.

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- How strongly have tax laws influenced the measurement of items in the financial statements?
- What is the aim of the financial statements? Are they intended to show a fair commercial view or a legal one?

The answers to these questions have resulted in a spectrum of accounting systems. At one extreme is what might be called the "legalistic" framework, where financial statements are drawn up in accordance with a rigid set of rules, irrespective of whether adherence to those rules contradicts the commercial realities. At the other extreme is the "commercial" framework where the only inviolable rule is that the financial statements must give a clear and realistic picture of the performance and financial position of the reporting company.

Historically, with the notable exception of Japan, those countries with larger securities markets, where the emphasis has been on raising business finance through equity rather than debt, have tended to fall in the commercial half of the spectrum; the interests of the investor or potential investor are paramount. Correspondingly, countries in the other half of the spectrum are those where, in the past, securities markets have been less strong and banks have played a more dominant finance role in the economy.

However, the distinction between the two is being blurred by the trend toward international harmonisation, a trend that is being driven by macroeconomic factors such as the arrival of the single European market, the globalisation of securities trading and indeed the increase in the size of securities markets throughout the world.

It should be remembered that current practices in many countries are interlinked through historical and economic connections. Indeed, there have been relatively few generators of accounting philosophy and many of the new industrialised nations with younger professions have either adopted procedures of a particular country or group of countries, or have opted to follow international standards in total.

Legalistic Framework

Under these systems the emphasis is directed more to:

- safeguarding the interests of creditors and providers of loan finance above those of the shareholders, creating a tendency to conservatism in valuation principles and the creation of hidden reserves.
- determining tax liabilities, which give rise to very detailed rules for income measurement and asset valuation and the way in which items must be charged in the financial statements. This can mean that the financial statements may be drawn up more for the benefit of the fiscal authorities than for other users, and overdepreciation and undervaluation of assets (for example) are not uncommon.

There tends to be great emphasis on uniformity of presentation. In countries such as France a General Accounting Plan is created so that the accounting system can serve as a tool for the furtherance of national economic objectives. The plan is established by the government to provide information on which policy making can be based, and the financial statements must comply with it in order to facilitate the extraction and comparison of financial information.

These systems require the auditor to report whether or not the financial statements have been drawn up correctly in accordance with the law rather than reporting on a "true and fair view". Many countries however which have historically followed a legalistic approach now also require reporting in terms of the truth and fairness of the financial statements. Less regard is paid to presenting a fair commercial view of a company's affairs to the investor. Consequently, in some countries, the auditor has little scope for exercising independent judgement.

Fair Commercial View

Here, the emphasis is placed on providing information to investors who are regarded as the prime users of the financial statements. The financial statements are intended to give a fair commercial view of a company's affairs and operations. Thus, there is less rigidity in the legal framework, and taxation requirements do not determine the format of the financial statements. By and large, standard setting tends to be the responsibility of the professional bodies, and the system is more flexible in response to changing circumstances as a result.

This flexibility also shows through at the individual entity level, and the auditor may exercise greater judgement in giving his opinion, which is directed to "fair presentation".

In some cases, this principle of truth and fairness, which in itself may be a legal requirement (for example, as in the United Kingdom), overrules other legal requirements if the fair commercial picture would be distorted by strict compliance with those other requirements.

Often referred to as the "Anglo-Saxon" approach, the main adherents to this philosophy include the United States, Canada, the United Kingdom, Australia, Hong Kong, Ireland, New Zealand, South Africa and the Netherlands.

Harmonisation Of Practice

The variations in financial statements drawn up under existing practices have led to attempts at harmonisation of accounting procedures and disclosure.

There are two affiliated international organisations of the accounting profession with a common membership, the International Accounting Standards Committee (IASC) and the International Federation of Accountants (IFAC). IASC has issued a series of International Accounting Standards (IAS) to define a set of accounting

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principles that can be adopted internationally, aiming to make financial statements comparable on a worldwide basis.

IAS are not mandatory, but the members of IASC - the principal accounting bodies in more than 60 countries - make every reasonable effort to comply with the standards. Some countries, such as Malaysia, adopted IAS almost in their entirety as national standards while others use IAS as the base for preparing their own standards. As well as issuing its own standards, IASC acts as a forum for the discussion by countries of differences in accounting principles and the ways in which these differences might be eliminated.

IFAC is seeking to achieve international harmonisation of auditing, ethical, and education standards; and its International Auditing Practices Committee (IAPC) is producing a series of International Standards on Auditing to develop and harmonise auditing practices throughout the world.

Within the European Community (EC), harmonisation has been addressed through the promulgation of accounting directives that must be incorporated into the national laws of the countries within the EC. The most important of these directives so far issued are the Fourth, which deals with the form and content of financial statements (and prescribes precise formats for the balance sheet and income statement), the Seventh, which governs the preparation of consolidated financial statements, and the Eighth which introduces rules for the regulation of auditors.

Disclosure/Measurement

Many countries require the basic financial statements to be expanded by explanatory notes in varying amounts of detail. These often include what is known as an "accounting policy" note, in which the company describes the particular methods it has adopted in preparing its financial statements. Many fundamental concepts (and some not-so-basic ones) are not disclosed. Variations across nations in the level and quality of disclosure is rarely a problem to those familiar with financial statements prepared in their own country but can leave a great deal of room for misinterpretation by foreigners. It is this area of uncertainty, in particular, that this book hopes to help remedy.

IAS1, "Disclosure of Accounting Policies", describes certain fundamental accounting assumptions that underlie the preparation of financial statements. These are:

- The enterprise is a going concern.
- Accounting policies have been applied consistently.
- Revenues and costs are recognised as they are earned or incurred.

In addition, certain considerations should govern the selection and application of the accounting policies. These are:

- Prudence - Transactions are often subject to uncertainties. This should be recognised by exercising prudence.
- Substance over form - Transactions should be dealt with according to financial reality (substance), not merely legal form.
- Materiality - Items should be disclosed if they are material enough to affect evaluations or decisions.

Depending on the amount and quality of the disclosure, the reader can then ask, "How has that item been measured?" In other words, "What methods have been used to fix its value at a particular point in time?" For example, replacement cost is often used in the Netherlands; the last-in-first-out method (LIFO) of valuing inventory is rarely permitted - one notable exception being the United States.

Format for this Book

The book has been prepared to give an overall view for each country of the framework within which the financial statements are prepared. The detailed subjects that follow cover the major elements of financial reporting, and items of topical interest.

The first chapter in this book describes the international pronouncements under these headings as a yardstick against which countries' actual practices can be compared. The second chapter looks more closely at the requirements of European Community Directives, which, although not all yet taken up by member states, clearly show the "Anglo-Saxon" drift of the Community toward reporting practice followed in the United States. Subsequently, the book is divided into chapters covering each country's accounting and reporting practices, and for each country most of the following subjects are covered, in the order shown here:

Form and Content of Financial Statements

Public Filing Requirements

Attitude to International Harmonisation of Accounting Standards

Audit Requirements

Valuation Principles

Group Financial Statements

Fundamental Accounting Concepts

Depreciation

Leasing

Introduction

Research and Development

Inventories

Intangible Assets

Capital and Reserves

Foreign Currency Translation

Taxation

Unusual and Prior Period Items

Retirement Benefits

Government Grants

Related Party Transactions

Segmental Information

Contingencies and Commitments

Price Level Changes

Accounting for Smaller Entities

Future Developments

In Conclusion

Because of the diversity of practice, be warned against taking apparent harmonisation at face value. In particular, an audit report that mentions the words presents fairly or the phrase true and fair view may actually be referring to a fair legalistic view (that is, a correct, legal view) and not a commercial view. Translation of stock phrases from one language into another may not succeed in translating conventional (but unspoken) interpretations of their meaning.

It is hoped that this book will be of help in giving a clearer picture of the similarities and differences where they exist.

International Standards and Guidelines

This chapter summarises some of the requirements included in the International Accounting Standards (IAS) published by The International Accounting Standards Committee (IASC) and in the International Standards on Auditing (ISA) published by the International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC).

The importance of International Accounting Standards has been increasing in recent years. In 1995, the IASC reached an agreement with the International Organisation of Securities Commissions (IOSCO) that IOSCO would consider endorsing International Accounting Standards for cross-border capital raising and listing purposes in all global markets upon completion by the IASC of a core set of standards. This core set of standards included issues on which the IASC had no existing standard, and it also meant a review of a number of existing International Standards. The timetable for the production of this core set of standards is March 1998, and at the time of writing the IASC is in the middle of a large project to produce this core of standards.

The main projects the IASC are and have been working on are in the following areas:

- Income taxes;
- Segment reporting;
- Earnings per share;
- Presentation of financial statements;
- Employee benefits;
- Impairment;
- Intangible assets, Research and Development, and Goodwill;
- Leasing;
- Discontinuing operations;
- Interim financial reporting;
- Provisions and contingencies;
- Financial instruments and Investments; and
- Agriculture.

International Standards and Guidelines

New standards have been issued on income taxes (IAS 12 revised) and earnings per share (IAS 33), both with an effective date of 1 January 1998.

A revised standard on segmental reporting (IAS 14 revised) has also been approved by the IASC, but at the time of writing has not been published. A standard on the presentation of financial statements has also been approved but not yet published; this standard will replace IAS 1, IAS 15 and IAS 13. Both of these standards have an effective date of 1 July 1998 and will be effective for accounting periods beginning on or after that date.

The IASC is continuing work on the other areas, which are at various stages of completion.

The synopsis of International Standards given below takes account of the revision to IAS 12 and the new IAS 33 as noted above, but in all other areas deals with existing standards.

Form and Content of Financial Statements

The preface to IAS explains that financial statements cover balance sheets, income statements, statements of changes in financial position, and notes and other explanatory material. Statements of changes in financial position are required by IAS7.

Three fundamental accounting assumptions - going concern, consistency and accruals - underlie financial statements that are presented in accordance with IAS. The concepts of prudence, substance over form, and materiality should govern the selection of accounting policies. IAS are not intended to apply to immaterial items. IASC has also issued a "Framework for the Preparation and Presentation of Financial Statements" which deals with the objectives and qualitative characteristics of financial statements, the definition, recognition and measurement of the elements of financial statements and concepts of capital and capital maintenance. It also identifies the users of financial statements and their needs.

IAS5 includes a detailed list of items required to be disclosed, whether on the face of the income statement or balance sheet, or in the notes. These basic disclosure requirements are augmented by the requirements of other IAS.

IAS5 includes the overall requirement that "all material information should be disclosed that is necessary to make the financial statements clear and understandable," and it also requires financial statements to show comparative figures for the preceding period.

Audit Requirements

In cases where national laws or conventions require an audit report, guidance to auditors is provided by an IAPC Standard (ISA 13) that covers the form and content

International Standards and Guidelines

of the auditor's report issued after an independent audit of the financial statements. The audit report should contain a "clear written expression of opinion on the financial information" and should represent the auditor's overall conclusion as to whether:

- the financial information has been prepared using acceptable accounting policies, which have been consistently applied;
- the financial information complies with relevant regulations and statutory requirements;
- the view presented by the financial information as a whole is consistent with the auditor's knowledge of the business of the entity; and
- there is adequate disclosure of all material matters relevant to the proper presentation of the financial statements.

Four categories of audit opinion are recognised: unqualified, qualified, and adverse opinions, and a disclaimer of opinion. Where a qualified opinion is given the reasons should be stated in the audit report in a clear and informative manner.

Valuation Principles

IAS generally are based on the historical cost basis of accounting but IAS16 allows the revaluation of property, plant, and equipment and IAS25 allows the revaluation of investments. IAS2 permits the valuation of inventory on a LIFO basis. IAS28 requires investments to be valued using the equity method in consolidated financial statements and either at cost, equity or revalued amount in the investors individual financial statements.

Financial statements are required by IAS1 to include clear and concise disclosure of all significant accounting policies.

In hyperinflationary economies IAS29 requires financial statements to be adjusted and stated in terms of the measuring unit current at the balance sheet date.

Group Financial Statements

Consolidated financial statements are required, under IAS27, to be prepared by enterprises (parents) that control one or more other enterprises (subsidiaries). Control is defined as the "power to govern the financial and operating policies of the subsidiary so as to obtain benefit from its activities". Both foreign and domestic subsidiaries are required to be consolidated but subsidiaries should be excluded from the consolidation if control is intended to be temporary or if they operate under severe long-term restrictions that impair control by the parent. Such subsidiaries are accounted for as investments (IAS25).

Parents do not require consolidated financial statements if they themselves are wholly owned, or if they are "virtually" wholly owned and the minority shareholders do not object. In such cases, the name and registered office of the ultimate parent should be disclosed.

International Standards and Guidelines

The members of the group should have uniform accounting reference dates, and consolidated financial statements should be prepared using uniform accounting policies unless it is impracticable to do so.

IAS28, "Accounting for Investments in Associates" requires that such investments be accounted for by the equity method in consolidated financial statements, unless it was purchased for resale in which case it should be valued at cost. Under the equity method the investor's share of the investee's results of operations are included in the consolidated income statement and the carrying amount of the investment is adjusted for any change in the net assets of the investee. Associations are defined as enterprises in respect of which the investor has no intention of disposing of its interest and over which the investor has significant influence, ie, the power to participate in (but not control) the financial and operating policy decisions. Significant influence is presumed when 20% or more of the voting power of the investee is held, unless it can clearly be demonstrated otherwise; equally it is presumed that significant influence is not exercised where less than 20% is held, again, unless demonstrated otherwise.

IAS31 deals with the treatment of joint ventures, which are contractual arrangements between two or more parties who share in the control of an activity in such a way that joint managerial decisions are required. Those enterprises that conduct a proportion of their activities as joint ventures, or whose joint ventures are an extension of their other activities, may account for them using the proportionate consolidation method. Under this method the investor's pro-rata share of the assets, liabilities, revenues, and expenses of each joint venture are aggregated with those in its own financial statements. The equity method of accounting is however an allowed alternative.

IAS22 describes two ways of accounting for business combinations:

- The purchase method, under which fair values are attributed to the assets and liabilities of a subsidiary acquired and any balance of the purchase price remaining is accounted for as goodwill. Positive goodwill should be amortised over its useful life. IAS 22 states that the amortisation period should not exceed five years unless a longer period, not exceeding twenty years from the date of acquisition, can be justified.

Negative goodwill should be allocated to non-monetary assets, or treated as deferred income. If the latter treatment is adopted, it should be regarded as income on a systematic basis over a period not exceeding five years unless a longer period, not exceeding twenty years from the date of acquisition, can be justified.

- The pooling of interests method, under which the assets, liabilities, income, and expenses of the combining enterprises are included in the financial statements for the period in which the combination occurs and for any comparative period as if the enterprises had been combined from the start of those periods.