International reporting Standards

Over the last 15-20 years, the financial world has undergone a major transformation. These developments have been mainly attributable to dramatic changes in the business and political climates, increasing global competition and rapid technological improvements whilst at the same time, the world's financial centres have grown increasingly interconnected (Reinstein, Weirich,, 2002).

These developments have left financial managers facing several major issues. One major issue that continues to re-emerge time and time again is the diversity of financial reporting standards, between trading nations.

As the principle objective of financial accounting being to provide all the information required in making sound economic decisions, companies are required to produce the following financial statements:

1. Trading profit and Loss Accounts
2. Balance sheets
3. Cash flow statements

However, even with these financial statements, it is not always possible for financial managers to make sound economic decisions due to the differences that exist in accounting standards (Blake, 1997).

Accounting Systems

The modern day global market place has many different accounting systems that operate under their respective professional accounting bodies. The major accounting practices are found in the U.S. the U.K. and also Europe that operates under the control of several different accounting standards.

U.S.

The U.S Generally Accepted Accounting Principles (GAAP) is a largely rule based approach to financial reporting. It is based on tens of thousands of pages of accounting rules that have been accumulated over decades. For example, there are around six hundred pages on derivatives alone. U.S GAAP contains many so-called 'bright lines' (Nobes, 1995). This system extends beyond the U.S. into Canada, Mexico and more recently Japan.

U.K.

GAAP in the U.K. differs significantly than in the U.S., largely due to the differences in the size of the economies. While the U.S. concept of GAAP draws on the a hierarchy of official recommendations headed up by the FASB (Sauder, 1991) this is in contrast to the U.K. standards that are set by the Financial Reporting Standards (FRS). Companies operating within the U.K. are obliged to operate within FRS, these rules tell companies the layout and what has to be included and disclosed. Whilst the differences between the two systems have narrowed in recent years, several major differences still remain.

Europe

Within Europe there are several accounting systems that operates under the control of different professional accounting bodies. A major feature of this system is the strong link between accounting and tax rules. In some cases the European tax regulations

offer opportunities to reduce taxable income compared to the provisions of commercial law. However these tax benefits may only be enjoyed if the same accounting treatment is followed in the published accounts (Elliot, 2002).
It is widely believed that to compete with the capital markets of the U.S. and U.K., Europe has to establish an integrated Pan-European financial and capital marketplace. In doing so it must first make it easier to compare companies financial statements and therefore gaining a true and accurate account of each company's performance (Wilson, 2002).

It is widely believed that the E.U. is in need of several major changes so it can deal with the following *Problems:*

- Different variations in the legal structures of companies. I.e. Partnerships V.s PLC's
- Deciding the legal domicile of the company i.e were the headquarters is situated.
- In establishing a valuation basis for the business i.e. a standard format for valuing assets
- And meeting the regulatory requirements in each country

The European commission believes that the solution to these problems is to introduce a single financial reporting framework for listed E.U. companies. The framework they chose to introduce is the International Accounting standards (IAS).

International Accounting Standards Committee
The aim of ISAC is to develop in the public interest a single set of global accounting standards that provide financial statements with high quality, transparent and comparable information. ISAC aims to:

- make it easier for those participants of global markets to make sound economic decisions.
- promote the use and rigorous application of these standards
- bring about convergence of national accounting standards and provide high quality solutions (Eiteman et al, 2000).

IAS follows a principle-based approach that now seemed to be the way forward.

IAS in the U.S.
The proposal to introduce Principle-based standard setting in the U.S, which was forwarded by the FASB, stated that-
"The main differences between accounting standards developed under a principles - based approach and existing accounting standards are (1) the principles would apply more broadly than under existing standards, thereby providing few, if any, exceptions to the principles and (2) there would be less interpretive and implementation guidance…for applying the standards.
Under IAS the rules which follow logically from the principles have much less complex exceptions than U.S GAAP

IAS in Europe
In an attempt to remove the barriers to cross border trading in securities by ensuring that company financial statements are transparent and comparable, in March 2002, the E.U. ruled that all companies with public shares listed in the European market must

bring their financial statements into line with IAS standards by 1st January 2005. This will mean some 7,000 companies who currently use their national GAAP taking on IAS. Senior management have began to recognise the far reaching impact that IAS will have on their businesses, with failure to implement these standards putting their company at a competitive disadvantage.

Global Harmonisation

Harmonization of worldwide standards has emerged, primarily due to:

- increased pressure from competitive global markets
- the recently reorganized ISAC, which has long sought to harmonize such standards
- Increased requirements for additional information regarding company financial performance
- Standardisation of
    - Presentation formats
    - Comparable valuation principles
    - The presentation of standard minimum information, that must be a fair and accurate view of the company performance. (McElree, 2003)

In recent years many multinational businesses have entered into international accounting harmonisation to reduce both the cost of analysing accounts from different countries and from running different accounting systems in different countries. Harmonisation will ensure that the same situations will be accounted for in the same way.

There are two main factors that influence current accounting systems, these are tax influence and capital market influence. Tax influence is where there may be a close relationship between accounts produced and taxation assessment of the company. With an accounting system that is affected by capital market influence, information needs of investors is the priority with the accounts produced bearing no obvious relationship to the tax system.

Tax influenced Country's

In country's where tax influence is strong such as France and Spain, the accounting rules are embedded in national laws so are difficult to change. Accounts are also prepared to meet requirements of tax authorities so these authorities are seen as the people who determine what should be on the accounts as the views of the tax authority are highly influential. The capital is traditionally provided by the banking sector with the reported profits being as low as possible, staying in line with the accounting code.

Capital Market influenced country's

In countries where capital market influence is strong such as the US and UK, reliance is placed on financial statements as the accounts are prepared for the needs of investors. These financial statements give a good picture of how the company is performing allowing investors to decide on what course of action they should take with the company whether it be to invest or pull-out. There are also separate systems for accounting and tax, with adjustments made to accounts to meet the needs of tax authorities. This again gives a better picture of how the company is performing. The reported profits on such accounts are subjected to professional judgement and can sometimes vary widely.

Currently there is a lot of differences in the financial reporting of various figures on accounts in different country's. A fundamental difference lies in the re-evaluation of property, plants and equipment. Overseas, it is common for countries to permit periodic re-evaluation of such assets, either up or down. The U.S. doesn't allow for such upward re-evaluations, resulting in real estate owned by American companies being worth a lot more that is reflected in the books (Cassell, 2003). Amounts and rates may also vary in different countries when it comes to depreciation, goodwill, stock or taxation. With harmonisation, all these differences will not be an issue with all the accounts following the same set of rules.

Harmonisation of accounts will bring with it a financial reporting language that will enable company's to be understood in a global market place. It will help them access world capital markets, reduce costs and will allow them to benchmark themselves against international players. It also allows multi-national groups to apply common accounting across their subsidiaries, which can improve internal communications, and the quality of management reporting and group decision-making (Heesen, 2003).

There are further obstacles which financial managers must consider such as the different accounting systems which are in operation in various countries. As already mentioned, the UK has a different system than that of the French or Spanish and this can be found all over Europe. The French and Spanish have their accounting practices closely linked to their tax systems which will need to be separated to allow for international standards to be introduced. The proposed international accounting standards will also diminish the amount of options available under the accounting rules. Such things as the calculation of depreciation and the valuation of assets will be given a set rule with no other options in the way its value will be calculated. This will ensure that all values are calculated in the same way allowing for comparisons to be conducted more effectively and accurately.

The Future

The Financial Accounting Standards Board (FASB) who represent America and the International Accounting Standards Board (IASB) who are the European representatives are working closely to bring their standards nearer to international norms. These new rules that the IAS has outlined must be abided by January 2005. The same goes for the US companies under the (FAS) bringing all standards in line with each other. The ultimate goal is to create one set of global accounting standards. In doing so will boost cross-border investment, deepen international capital markets and save multinational companies, who must currently report under multiple systems, a lot of time and money (Vesey, 2003). They aim to achieve this by reducing options open to accountants regarding valuation of assets, calculation of profits, valuation of stocks and use of discretion in preparing accounts.