To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

CHAPTER 3

Comparative Accounting: Europe

In Chapter 2 we learned about the factors that affect the development of a nation's accounting system, including its sources of finance, legal system, taxation, political and economic ties, and inflation. Chapter 2 went on to classify accounting systems according to their common elements and distinctive features.

Chapters 3 and 4 more closely examine accounting in a few selected countries. Specific knowledge of accounting in a country is needed to analyze financial statements from that country. Chapter 3 deals with five European countries. Chapter 4 deals with five countries from the Americas and Asia. Background information for each country is provided in both chapters, along with a discussion of each country's institutional framework for regulating and enforcing accounting. Financial reporting based on local generally accepted accounting principles (GAAP) is also discussed. The global convergence toward International Financial Reporting Standards (IFRS) (Chapter 8), notwithstanding, we believe that analysts need to have knowledge about local GAAP and institutional arrangements. That's because many companies are simply unaffected by the convergence movement. For example, some 8,000 listed European companies must now prepare their consolidated financial statements according to IFRS. But the estimated 3 million nonlisted European companies are not directly affected by the IFRS requirement. Research also shows that the application of IFRS by European companies reflects national norms and conventions.[1] As another example, U.S., Japanese, and Chinese companies must follow their respective national GAAP, not IFRS. Even though financial reporting standards and practices are converging for many companies around the world, differences remain for many others.

Chapter 3 focuses on five members of the European Union (EU): the Czech Republic, France, Germany, the Netherlands, and the United Kingdom. France, Germany, and the Netherlands were original members of the European Economic Community when it was established in 1957. The United Kingdom joined in 1973.

[1] Isabel von Keltz and KPMG, *The Application of IFRSs: Choices in Practice* (December 2006), www.kpmg.com.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

All four of these countries have highly developed economies and are home to many of the world's largest multinational corporations. They were among the founders of the International Accounting Standards Committee (now the International Accounting Standards Board, or IASB), and they have a major role in directing its agenda. The Czech Republic is an "emerging" economy.[2] Until 1989 a member of the now defunct Soviet bloc, it is converting from a planned to a market economy. Accounting developments there are representative of those in other former Soviet bloc countries. The Czech Republic joined the EU in 2004.

Exhibit 3-1 contains some comparative economic data about the five countries discussed in this chapter. The contrast between the Czech Republic and the other four countries is apparent. Its gross domestic product (both in absolute terms and per capita), imports and exports, and stock market capitalization are significantly smaller than those of the other four countries. It also has more of an industrial and less of a service economy than the other countries.

EXHIBIT 3-1 Economic Data for Selected Countries

	France	Germany	Czech Republic	The Netherlands	United Kingdom
Area: sq. km.(in thousands)	544	358	79	42	243
Population (in millions)	60.7	82.7	10.2	16.4	59.8
Gross Domestic Product (in billions)	$2,248	$2,897	$143	$662	$2,377
GDP per Capita	$37,040	$35,030	$14,020	$40,380	$39,750
GDP by Sector					
Agriculture	2%	1%	3%	2%	1%
Industry	20%	30%	38%	24%	23%
Services	78%	69%	59%	74%	76%
Imports (in billions)	$535	$922	$93	$359	$591
Exports (in billions)	$483	$1,122	$95	$401	$448
Market Capitalization (in billions), end 2007	$2,771	$2,106	$73	$956	$3,859
Major Trading Partners	Germany, Spain, Italy	France, U.S.A., U.K.	Germany, Slovakia, Russia	Germany, Belgium, U.K.	U.S.A., Germany, France

Source: Compiled from *Pocket World in Figures, 2009 Edition* (London: The Economist, 2008) and *The World Factbook,* www.cia.gov/library/publications/the-world-factbook/, May 2009.

[2] The term emerging economy refers loosely to newly industrialized countries (NICs) and countries in transition from planned to free-market economies. NICs have experienced rapid industrial growth, but their economies are not yet rich in terms of per capita gross domestic product. India, discussed in Chapter 4, is a NIC. The Czech Republic has an economy in transition.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

SOME OBSERVATIONS ABOUT ACCOUNTING STANDARDS AND PRACTICE

Accounting standards are the regulations or rules (often including laws and statutes) that govern the preparation of financial statements. *Standard setting* is the process by which accounting standards are formulated. Thus, accounting standards are the outcome of standard setting. However, actual practice may deviate from what the standards require. There are at least three reasons for this. First, in many countries the penalties for noncompliance with official accounting pronouncements are weak or ineffective. Companies don't always follow standards when they are not enforced. Second, companies may voluntarily report more information than required. Third, some countries allow companies to depart from accounting standards if doing so will better represent a company's results of operations and financial position. To gain a complete picture of how accounting works in a country, we must pay attention to the accounting standard-setting process, the resulting accounting standards, and actual practice. *Auditing* adds credibility to financial reports. Thus, we also discuss the role and purpose of auditing in the countries we examine.

Accounting standard setting normally involves a combination of private- and public-sector groups. The private sector includes the accounting profession and other groups affected by the financial reporting process, such as users and preparers of financial statements and employees. The public sector includes such agencies as tax authorities, government agencies responsible for commercial law, and securities commissions. Stock exchanges may influence the process and may be in either the private or public sector, depending on the country. The roles and influence of these groups in setting accounting standards differ from country to country. These differences help explain why standards vary around the world.

The relationship between accounting standards and accounting practice is complex, and does not always move in a one-way direction. In some cases, practice derives from standards; in others, standards are derived from practice. Practice can be influenced by market forces, such as those related to the competition for funds in capital markets. Companies competing for funds may voluntarily provide information beyond what is required in response to the demand for information by investors and others. If the demand for such information is strong enough, standards may be changed to mandate disclosures that formerly were voluntary.

Chapter 2 distinguished the fair presentation and legal compliance orientations of accounting. Fair presentation accounting is usually associated with common law countries, whereas legal compliance accounting is typically found in code law countries. This distinction applies in standard setting, in that the private sector is relatively more influential in fair presentation, common law countries, while the public sector is relatively more influential in legal compliance, code law countries. Auditing parallels the type of legal system and the role and purpose of financial reporting. The auditing profession tends to be more self-regulated in fair presentation countries, especially those influenced by the United Kingdom. Auditors also exercise more judgment when the purpose of an audit is to attest to the fair presentation of financial reports. By contrast, in code law countries the accounting profession tends to be more state regulated. In such countries, the main purpose of an audit is to ensure that the company's records and financial statements conform to legal requirements.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

IFRS IN THE EUROPEAN UNION

The trend in financial reporting is toward fair presentation, at least for consolidated financial statements. This trend is particularly true in the European Union. In 2002, the EU approved an accounting regulation requiring all EU companies listed on a regulated market to follow IFRS in their consolidated financial statements, starting in 2005. Member states are free to extend this requirement to all companies, not just listed ones, including individual company financial statements. Exhibit 3-2 summarizes the EU requirements for using IFRS in the five countries surveyed in this chapter. Convergence in financial reporting can be expected where IFRS are required, but differences remain where they are not.

To understand accounting in Europe, one must understand both IFRS and local accounting requirements. Many companies will choose to follow local requirements in instances where IFRS are permitted. For example, they may view IFRS as not relevant for their needs or too complicated. Thus, we provide an overview of IFRS in this section. The rest of the chapter looks at accounting in the five countries surveyed.

FINANCIAL REPORTING IFRS financial statements consist of the consolidated statement of financial position, statement of comprehensive income, cash flow statement, a statement of changes in equity, and explanatory notes. Note disclosures must include:

- Accounting policies followed
- Judgments made by management in applying critical accounting policies
- Key assumptions about the future and other important sources of estimation uncertainty

EXHIBIT 3-2 **IFRS Requirements**

	Czech Republic	France	Germany	The Netherlands	United Kingdom
Listed companies—consolidated financial statements	Required	Required	Required	Required	Required
Listed companies—individual company financial statements	Required	Prohibited[a]	Permitted, but for informational purposes only[a]	Permitted	Permitted
Nonlisted companies—consolidated financial statements	Permitted	Permitted	Permitted	Permitted	Permitted
Nonlisted companies—individual company financial statements	Prohibited[b]	Prohibited[a]	Permitted, but for informational purposes only[a]	Permitted	Permitted

[a]*French and German individual company financial statements must be prepared using local accounting requirements because these statements are the basis for taxes and dividends.*

[b]*IFRS are not allowed in individual company financial statements of Czech nonlisted companies because it is thought that IFRS would be too complex and costly for these small, privately owned firms.*

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

Comparative information is only required for the preceding period. There is no IFRS requirement to present the parent entity's financial statements in addition to the consolidated financial statements. There are also no IFRS requirements to produce interim financial statements. Consolidation is based on control, which is the power to govern the financial and operating activities of another entity.[3] Generally, all subsidiaries must be consolidated even if control is temporary or the subsidiary operates under severe long-term funds-transfer restrictions. Fair presentation is required. IFRS may be overridden in extremely rare circumstances to achieve a fair presentation. When they are, the nature, reason, and financial impact of the departure from IFRS must be disclosed.

ACCOUNTING MEASUREMENTS Under IFRS, all business combinations are treated as purchases. Goodwill is the difference between the fair value of the consideration given and the fair value of the subsidiary's assets, liabilities, and contingent liabilities. Goodwill is tested annually for impairment. Negative goodwill should be immediately recognized in income. Jointly controlled entities may be accounted for either by proportional consolidation (preferred) or the equity method. Investments in associates are accounted for by the equity method. An associate is an entity in which the investor has significant influence, but which is neither a subsidiary nor a joint venture. Significant influence is the power to participate in the financial and operating policy decisions of the investee but not to control those policies. It is presumed to exist when the investor holds at least 20 percent of the investee's voting power and not to exist when less than 20 percent is held; these presumptions may be rebutted if there is clear evidence to the contrary.

Translation of the financial statements of foreign operations is based on the functional currency concept. The functional currency is the currency of the primary economic environment in which the foreign entity operates. It can be either the same currency that the parent uses to present its financial statements or a different, foreign currency. (a) If the foreign entity has a functional currency different from the reporting currency of the parent, the financial statements are translated using the current rate method with the resulting translation adjustment included in stockholders' equity. (Under the current rate method, assets and liabilities are translated at the year-end, or current, exchange rate; revenues and expenses are translated at the transaction rates [or, in practice, the average rate].) (b) If the foreign entity has the same functional currency as the reporting currency of the parent, financial statements are translated as follows:

- Year-end rate for monetary items
- Transaction-date exchange rates for nonmonetary items carried at historical cost
- Valuation-date exchange rates for nonmonetary items carried at fair value

Translation adjustments are included in current period income. (c) If a foreign entity has the functional currency of a hyperinflationary economy, its financial statements are first restated for the effects of inflation, then translated using the current rate method described above.

Assets are valued at either historical cost or fair value. If the fair value method is used, revaluations must be carried out regularly and all items of a given class must be

[3] The IASB is proposing a new definition of control: when the reporting entity has the power to direct the activities of another entity to generate returns for the reporting entity.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

revalued. Revaluation increases are credited to equity. Depreciation is charged systematically over the asset's useful life, reflecting the pattern of benefit consumption. Research costs are charged to expense when incurred. Development costs are capitalized after the technical and commercial feasibility of the resulting product or service has been established. Inventories are valued at the lower of cost or net realizable value. FIFO and weighted average are acceptable cost bases under IFRS, but LIFO is not.

Finance leases are capitalized and amortized, while operating leases are expensed on a systematic basis, usually expensing the lease payments on a straight-line basis.[4] The cost of providing employee benefits is recognized in the period in which the benefit is earned by the employee rather than when it is paid or payable. Provisions are liabilities of uncertain timing or amount. They are recognized when a past event has created a legal or constructive obligation, an outflow of resources is probable, and the amount of the obligation can be estimated reliably. Contingent liabilities are a possible obligation, an obligation that will probably not require an outflow of resources, or an obligation that cannot be reliably estimated. They are not recognized as liabilities, but are instead disclosed in the notes.[5] Contingent assets are also not recognized. Deferred taxes are provided in full, using the liability method, for temporary differences between the carrying amount of an asset or liability and its tax base. Deferred tax assets and liabilities should be measured at the tax rates that are expected to apply when the asset is realized or the liability is settled. They are not discounted.

FIVE NATIONAL FINANCIAL ACCOUNTING SYSTEMS[6]

France

France is the world's leading advocate of national uniform accounting. The Ministry of National Economy approved the first formal Plan Comptable Général (national accounting code) in September 1947. A revised plan came into effect in 1957. A further revision of the plan was enacted in 1982 under the influence of the Fourth Directive of the European Union (EU). In 1986 the plan was extended to implement the requirements of the EU's Seventh Directive on consolidated financial statements, and it was further revised in 1999.

The Plan Comptable Général provides:

- objectives and principles of financial accounting and reporting
- definitions of assets, liabilities, shareholders' equity, revenues, and expenses
- recognition and valuation rules

[4] The IASB is proposing that all material leases be capitalized, discontinuing the distinction between financing and operating leases.

[5] The IASB is currently deliberating the definitions of the elements of the financial statements in its joint Conceptual Framework project with the U.S. Financial Accounting Standards Board (see Chapter 8). The term "contingent liability" will probably no longer be used. Instead, liabilities will be assessed in terms of whether they are "conditional or unconditional obligations." See *Conceptual Framework – Phase B: Elements and Recognition* at the IASB Web site, www.iasb.org.

[6] The discussion in this section draws on the references cited in this chapter and on references cited in earlier editions of this book. The Big Four accounting firms and the IAS Plus Web site (www.iasplus.com) periodically update details of accounting in individual countries. For example, the discussion of accounting in the Netherlands later in this chapter is based in part on Deloitte, *IFRSs and NL GAAP: A Pocket Comparison* (April 2008), www.iasplus.com/dttpubs/0805ifrsnlgaap.pdf.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

- a standardized chart of accounts, requirements for its use, and other bookkeeping requirements
- model financial statements and rules for their presentation

The mandatory use of the national uniform chart of accounts does not burden French businesses because the plan is widely accepted in practice. Moreover, various schedules required for income tax returns are based on the standardized models of the income statement and balance sheet, and the state statistical office produces macroeconomic information by aggregating the financial statements of enterprises.

French accounting is so closely linked to the plan that it is possible to overlook the fact that commercial legislation (i.e., the Code de Commerce) and tax laws dictate many of France's actual financial accounting and reporting practices. Both of these predate the plan. The Code de Commerce has its roots in the 1673 and 1681 ordinances of Colbert (finance minister to Louis XIV) and was enacted by Napoleon in 1807 as a part of the legal system he created, based on written law. The first income tax law was passed in 1914, thereby linking taxation and the need to keep accounting records.

The main bases for accounting regulation in France are the 1983 Accounting Law and 1983 Accounting Decree, which made the Plan Comptable Général compulsory for all companies. Both texts are inserted in the Code de Commerce.[7] Commercial legislation in the Code de Commerce has extensive accounting and reporting provisions. Annual inventories of assets and liabilities are required. The true and fair view for financial reporting must be evidenced, and certain accounting records are granted a privileged role in specified judicial proceedings. Accounting records, which legally serve purposes of proof and verification, are increasingly considered sources of information for decision-making.

Each enterprise must establish an accounting manual if it believes that this is necessary to understand and control the accounting process. At a minimum, the manual includes a detailed flow chart and explanations of the entire accounting system, descriptions of all data-processing procedures and controls, a comprehensive statement of the accounting principles underlying annual financial statements, and the procedures used in the mandatory annual counting of inventory.

Tax laws also significantly influence accounting in France. Business expenses are deductible for tax purposes only if they are fully booked and reflected in annual financial statements.

ACCOUNTING REGULATION AND ENFORCEMENT Five major organizations are involved in setting standards in France:[8]

1. Counseil National de la Comptabilité, or CNC (National Accounting Board)
2. Comité de la Réglementation Comptable, or CRC (Accounting Regulation Committee)

---

[7] The legal framework for accounting includes laws passed by Parliament, government decrees dealing with the application of these laws, and ministerial orders by the Ministry of Economy and Finance.

[8] The Web site addresses are CNC and CRC: www.minefi.gouv.fr/directions_services/CNCompta; AMF: www.amf-france.org; OEC: www.experts-comptables.com; and CNCC: www.cncc.fr.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

3. Autorité des Marches Financiers, or AMF (Financial Markets Authority)[9]
4. Ordre des Experts-Comptables, or OEC (Institute of Public Accountants)
5. Compagnie Nationale des Commissaires aux Comptes, or CNCC (National Institute of Statutory Auditors)

The CNC consists of 58 members representing the accounting profession, civil servants, and employer, trade union, and other private-sector groups. Attached to the Ministry of Economy and Finance, the CNC issues rulings and recommendations on accounting issues and has major responsibility for keeping the plan current. It is consulted on accounting matters requiring regulation, but has no regulatory or enforcement powers. In 2007, a 16-member Collège was formed to debate accounting issues before the CNC and make recommendations on their resolution. The establishment of the Collège is an interim step to further reforms of the standard-setting process, as discussed later.

Due to a need for a flexible and expeditious means of providing regulatory authority for accounting standards, the CRC was established in 1998. The CRC converts CNC rulings and recommendations into binding regulations. Under the jurisdiction of the Ministry of Economy and Finance, it has 15 members, among them representatives of different ministries, the CNC, AMF, OEC, and CNCC, and judges from the two highest courts in France. CRC regulations are published in the *Official Journal of the French Republic* after ministerial approval. Thus, the CRC has real regulatory power.

The French standard-setting system is undergoing a reform that will eventually replace the CNC and CRC with a new standard-setting body, the Autorité des Normes Comptables, or ANC (National Accounting Authority). Like the CNC and CRC, the ANC will be a state agency. It will be charged with issuing national accounting rules required for individual-company accounts. (Unlisted companies may use them in their consolidated financial statements, but they will also have the option of using IFRS.)

French companies traditionally have relied less on capital markets than on other sources of finance.[10] The French equivalent of the U.S. Securities and Exchange Commission—the AMF—has important but limited influence on accounting standard setting. The AMF supervises the new-issues market and the operations of regional and national stock exchanges. It has authority to issue additional reporting and disclosure rules for listed companies. The president of France appoints the chair of the AMF, and the commission reports annually to the president. This arrangement provides independence from other government departments.[11] The AMF is responsible for enforcing compliance with reporting requirements by French listed firms. Two divisions verify compliance. The Division of Corporate Finance (SOIF) conducts a general review of the legal, economic, and financial aspects of documents filed with the AMF (including annual reports). The Accounting Division (SACF) verifies compliance with accounting

[9] The AMF was established in 2003 from the merger of the Commission des Operations de Bourse (COB), the Conseil des Marchés Financiers, and the Conseil de Discipline de la Gestion Financière. The COB was the previous organization with authority over the stock exchanges.
[10] France has a tradition of family businesses and nationalized industries, both of which rely on debt financing.
[11] A predecessor body to the AMF, the Commission des Opérations de Bourse (COB), was an early advocate of consolidation requirements for French companies and, in general, sought French acceptance of world-class accounting and reporting standards—at least for larger publicly listed French companies. The COB pressed for better accounting and disclosure, and successfully improved the quality of information in French consolidated financial statements.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

standards. The AMF has broad powers to require companies to modify questionable items in their filings. If necessary, the AMF can take administrative action against a company to force compliance.[12]

In France the accounting and auditing professions have historically been separate. French accountants and auditors are represented by two bodies, the OEC and the CNCC, despite substantial overlap in their memberships. Indeed, 80 percent of France's qualified accountants hold both qualifications. The two professional bodies maintain close links and cooperate on issues of common interest. Both participate in the development of accounting standards through the CNC and CRC, and they represent France on the IASB.

The practice of public accounting and the right to the title *expert-comptable* is restricted to OEC members, who contract with clients to maintain and review accounting records and prepare financial statements. They may also provide tax, information systems, and management advisory services. The OEC is under the jurisdiction of the Ministry of Economy and Finance. Most of its effort is devoted to professional-practice issues, although before the CRC was established it issued interpretations and recommendations on the application of accounting legislation and regulations.

By contrast, the CNCC (professional association of statutory auditors, *commissaires aux comptes*) is under the jurisdiction of the Ministry of Justice. By law, only statutory auditors may audit and give an opinion on financial statements.[13] The CNCC publishes a member handbook that contains extensive professional standards. It also publishes information bulletins that provide technical assistance. Audits in France are generally similar to their counterparts elsewhere. However, French auditors must report to the state prosecutor any criminal acts that they become aware of during an audit. The Haut Conseil du Commissariat aux Comptes (High Council of External Auditors) was established in 2003 to monitor the audit profession, particularly in the areas of ethics and independence. Like the CNCC, it is under the Ministry of Justice. The 2003 law also requires an auditor's report on internal controls.[14]

The AMF is responsible for overseeing the audits of listed companies. However, the AMF relies on a committee of the CNCC (the Comité de l'Examen National des Activités, or CENA) to conduct audit-quality reviews on its behalf. By arrangement with the AMF, CENA examines the audit of each listed company at least once every six years.[15] Follow-up examinations are also done in cases where the auditor's work is found to be deficient.

FINANCIAL REPORTING French companies must report the following:

1. Balance sheet
2. Income statement
3. Notes to financial statements
4. Directors' report
5. Auditor's report

[12] For further information, see T.H.P Dao, "Monitoring Compliance with IFRS: Some Insights from the French Regulatory System," *Accounting in Europe* 2 (2005): 107–135.
[13] The same person can practice both accounting and auditing. However, independence rules prohibit the statutory auditor from also providing accounting services to the same client firm.
[14] The heightened oversight of the auditing profession and the new report on internal controls are in part a response to the same accounting scandals that gave rise to the Sarbanes-Oxley Act in the United States (Chapter 4).
[15] The normal period for an audit contract of a listed company in France is six years.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

The financial statements of all corporations and other limited liability companies above a certain size must be audited. Large companies must also prepare documents relating to the prevention of business bankruptcies and a social report, both of which are unique to France. There are no requirements for a statement of changes in financial position or a cash flow statement. However, the CNC recommends a cash flow statement, and nearly all large French companies publish one. Individual company and consolidated statements are both required, but small groups are exempt from the consolidation requirement. The Code de Commerce allows simplified financial statements for small and medium-sized companies.

To give a true and fair view (*image fidèle*), financial statements must be prepared in compliance with legislation (*régularité*) and in good faith (*sincérité*). A significant feature of French reporting is the requirement for extensive and detailed footnote disclosures, including the following items:

- Explanation of measurement rules employed (i.e., accounting policies)
- Accounting treatment of foreign currency items
- Statement of changes in fixed assets and depreciation
- Details of provisions
- Details of any revaluations
- Breakdown of receivables and liabilities by maturity
- List of subsidiaries and share holdings
- Amount of commitments for pensions and other retirement benefits
- Details of the impact of taxes on the financial statements
- Average number of employees listed by category
- Analysis of turnover by activity and geographically

The directors' report includes a review of the company's activities during the year, the company's future prospects, important post–balance sheet events, research and development activities, and a summary of the company's results for the past five years. The financial statements of commercial companies must be audited, except for small, limited liability companies and partnerships.

Listed companies must provide half-yearly interim reports and the results of their environmental activities. Among other items, information must be given on:

- Water, raw material, and energy consumption, and actions taken to improve energy efficiency
- Activities to reduce pollution in the air, water, or ground, including noise pollution, and their costs
- Amount of provisions for environmental risks

French law also contains provisions aimed at preventing bankruptcies (or mitigating their consequences). The idea is that companies that have a good understanding of their internal financial affairs and prepare sound projections can better avoid financial difficulties. Accordingly, larger companies prepare four documents: a statement of cash position, a statement of changes in financial position or cash flow statement, a forecast income statement, and a business plan. These documents are not audited, but are given a limited examination by the auditors. They are submitted only to the board of directors and employee representatives; they are not made available to the shareholders or the general public unless provided voluntarily (such as the cash

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

flow statement). Thus, this information is designed as an internal early-warning signal for management and workers.

A social report also is required for all companies with 300 or more employees. This report describes, analyzes, and reports on matters of training, industrial relations, health and safety conditions, wage levels and other employment benefits, and many additional relevant work-environment conditions. The report is required for individual companies, not consolidated groups.

ACCOUNTING MEASUREMENTS Listed French companies follow IFRS in their consolidated financial statements, and nonlisted companies also have this option. However, all French companies must follow the fixed regulations of the plan at the individual company level. Accounting for individual companies is the legal basis for distributing dividends and for calculating taxable income. Exhibit 3-3 provides an example of financial reporting by French listed firms. Saint-Gobain, a materials and construction products company listed in Paris and on other European stock exchanges, explains its accounting policies for its consolidated and nonconsolidated financial statements.

Tangible assets are normally valued at historical cost. Although revaluations are allowed, they are taxable and, therefore, are seldom found in practice. Fixed assets are depreciated according to tax provisions, normally on a straight-line or declining balance basis. Extra tax depreciation is sometimes available, in which case the additional amount taken is shown as an exceptional charge on the income statement and the corresponding credit as a tax-related provision in equity. Inventory must be valued at the lower of cost or realizable value using either First in, First Out (FIFO) or weighted-average methods.

Research and development costs are expensed as incurred, but may be capitalized in restricted circumstances. If capitalized, research and development costs must be amortized over no more than five years. Leased assets are not capitalized, and the rent paid is expensed. Pension and other retirement benefits are normally expensed when paid, and future commitments are seldom recognized as liabilities. Probable losses whose amounts can be determined with reasonable accuracy are accrued. Many other risks and uncertainties may be provided for, such as those relating to litigation, restructurings, and self-insurance; these allow income-smoothing opportunities. Given the link between book and tax income, companies do not account for deferred taxes in individual company financial statements. Legal reserves must be created by appropriating 5 percent of income each year until the reserve equals 10 percent of legal capital.

EXHIBIT 3-3 Saint-Gobain Accounting Policies

Note to consolidated financial statements
These consolidated financial statements of Compagnie de Saint-Gobain and its subsidiaries ("the Group") have been prepared in accordance with International Financial Reporting Standards (IFRS), as adopted by the European Union at December 31, 2008.

Note to parent company financial statements
The financial statements of Compagnie de Saint-Gobain have been drawn up in accordance with the accounting principles set out in the 1999 French Chart of Accounts.

Source: 2008 Saint-Gobain Annual Report, pp. 192 and 271.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

With a few exceptions, French rules regarding consolidated financial statements follow the fair presentation approach of reporting substance over form. Two exceptions are that liabilities for post-employment benefits do not have to be recognized and finance leases do not have to be capitalized. (In both cases, the fair presentation treatment of accrual and capitalization is recommended, but still optional.) Deferred taxes are accounted for using the liability method, and are discounted when the reversal of timing differences can be reliably estimated. The purchase method is normally used to account for business combinations, but the pooling method is allowed in some circumstances. Goodwill normally is capitalized and amortized to income, but no maximum amortization period is specified. Goodwill is not required to be impairments tested. Proportional consolidation is used for joint ventures and the equity method is used to account for investments in nonconsolidated entities over which significant influence is exercised. Foreign currency translation practice is consistent with IFRS, as previously described.

Germany

The German accounting environment has changed continuously and remarkably since the end of World War II. At that time, business accounting emphasized national and sectional charts of account (as in France). The Commercial Code stipulated various principles of "orderly bookkeeping," and independent auditing barely survived the war.

In a major turn of events, the 1965 Corporation Law moved the German financial reporting system toward British-American ideas (but only for larger corporations). More disclosure, limited consolidation,[16] and a corporate management report were required. The management report and additional audit requirements became legal requirements through the 1969 Corporate Publicity Law.

In the early 1970s the European Union (EU) began issuing its harmonization directives, which member countries were required to incorporate into their national laws. The Fourth, Seventh, and Eighth EU Directives all entered German law through the Comprehensive Accounting Act of December 19, 1985. This legislation is remarkable because (1) it integrates all existing German accounting, financial reporting, disclosure, and auditing requirements into a single law; (2) this single law is specified as the *third book* of the German Commercial Code (HGB), thus becoming applicable to all business entities, from limited partnerships to private and publicly held corporations; and (3) the legislation is based predominantly on European concepts and practices. The 1985 act was significantly updated in 2009 with the passage of the German Accounting Law Modernization Act.

Two laws were passed in 1998. The first added a new paragraph in the third book of the German Commercial Code allowing companies that issue equity or debt on organized capital markets to use internationally accepted accounting principles in their consolidated financial statements. The second allowed the establishment of a private-sector organization to set accounting standards for consolidated financial statements.

Creditor protection is a fundamental concern of German accounting as embodied in the Commercial Code. Conservative balance sheet valuations are central to creditor protection. This creates a tendency to undervalue assets and overvalue liabilities. Reserves are seen as protection against unforeseen risks and possible insolvency. These practices also result in a conservative income amount that serves as the basis for

[16] For example, the law only required consolidation of German subsidiaries.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

dividends to owners. Thus, German accounting is designed to compute a prudent income amount that leaves creditors unharmed after distributions are made to owners.

Tax law also influences commercial accounting. Available tax provisions can be used only if they are fully booked, meaning that there is no distinction between financial statements prepared for tax purposes and those published in financial reports. The concept of "tax determines financial accounting" once characterized German accounting. However, German accounting requirements in the HGB are gradually being aligned with international accounting standards.

The third fundamental characteristic of German accounting is its reliance on statutes and court decisions. Nothing else has any binding or authoritative status. To understand German accounting, one must look to both HGB and a considerable body of case law.

ACCOUNTING REGULATION AND ENFORCEMENT Before 1998, Germany had no financial accounting standard-setting function, as it is understood in English-speaking countries. The German Institute provided consultation in various processes of lawmaking that affected accounting and financial reporting, but legal requirements were absolutely supreme. Similar consultation was given by the Frankfurt Stock Exchange, German trade unions, and accounting academics. The 1998 law on control and transparency (abbreviated KonTraG) introduced the requirements for the Ministry of Justice to recognize a private national standard-setting body to serve the following objectives:

- Develop recommendations for the application of accounting standards for consolidated financial statements.
- Advise the Ministry of Justice on new accounting legislation.
- Represent Germany in international accounting organizations such as the IASB.

The German Accounting Standards Committee (GASC), or in German, the *Deutsches Rechnungslegungs* Standards Committee (DRSC), was founded shortly thereafter, and duly recognized by the Ministry of Justice as the German standard-setting authority.[17]

The GASC oversees the German Accounting Standards Board (GASB), which does the technical work and issues the accounting standards. The GASB is made up of seven independent experts with a background in auditing, financial analysis, academia, and industry. Working groups are established to examine and make recommendations on the issues before the board. As a rule, these working groups have representatives from trade and industry and the auditing profession, a university professor, and a financial analyst. GASB deliberations follow a due process and meetings are open. Once issued, the standards must be approved and published by the Ministry of Justice.

The new German accounting standard-setting system is broadly similar to the systems in the United Kingdom (as discussed in this chapter) and the United States (Chapter 4), and to the IASB (Chapter 8). It is important to emphasize, however, that GASB standards are authoritative recommendations that only apply to consolidated financial statements. They do not restrict or alter HGB requirements. The GASB was created to develop a set of German standards compatible with international accounting standards. Since its founding, the GASB has issued German Accounting Standards (GAS) on such issues as the cash flow statement, segment reporting, deferred taxes, and foreign currency translation. However, in 2003, the GASB adopted a new strategy that aligned its work

[17] The GASC Web site is www.drsc.de.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

program with the IASB's efforts to achieve a convergence of global accounting standards. These changes recognized the EU requirement for IFRS for listed companies.

The Financial Accounting Control Act (abbreviated BilKoG) was enacted in 2004 to improve compliance with German financial reporting requirements and IFRS by listed companies. The law established a two-tiered enforcement system. A private-sector body, the Financial Reporting Enforcement Panel (FREP), reviews suspected irregular financial statements that come to its attention. It also conducts random reviews of financial statements. The FREP relies on companies to voluntarily correct any problems it finds. The FREP refers matters that are not resolved to the Federal Financial Supervisory Authority (German abbreviation BaFin), the public-sector regulatory body that oversees securities trading (stock exchanges) and the banking and insurance industries. BaFin will then take authoritative action to resolve the issue. BaFin refers questionable auditing to the *Wirtschaftsprüferkammer*, discussed next.

Certified public accountants in Germany are called *Wirtschaftsprüfer* (WPs), or enterprise examiners.[18] All WPs are legally required to join the official Chamber of Accountants (*Institut der Wirtschaftsprüferkammer*). The Auditor Oversight Commission, which reports to the Ministry of Economics and Labor, is responsible for overseeing the Chamber of Accountants. By international standards, the German auditing (accounting) profession is small. The 1985 Accounting Act extended the audit requirement to many more companies. As a result, a second-tier body of auditors was created in the late 1980s. These individuals, known as sworn book examiners (*Vereidigte Buchprüfer*), are only allowed to audit small and medium-sized companies, as defined in the act. Thus, two classes of auditors are legally sanctioned to conduct independent audit examinations of companies. German audit reports emphasize compliance with requirements over the "true and fair view." Exhibit 3-4, the opinion paragraph of KPMG on the 2008 financial statements of the BMW automobile company, is illustrative.

FINANCIAL REPORTING German law specifies different accounting, auditing, and financial reporting requirements depending on company size rather than the form of business organization.[19] There are three size classes—small, medium, and large—defined in terms of balance sheet totals, annual sales totals, and numbers of employees. Companies with publicly traded securities are always classified as large. The law specifies the content and format of financial statements, which include the following:

1. Balance sheet
2. Income statement
3. Notes
4. Management report
5. Auditor's report

---

[18] The Institut der Wirtschaftsprüfer's Web site is www.wpk.de.

[19] The three major forms of business organizations in Germany are (1) *Aktiengesellschaft* (AG), (2) *Kommanditgesellschaft auf Aktien* (KGaA), and (3) *Gesellschaft mit beschränkter Haftung* (GmbH).

AGs are typically large corporations with two senior boards: a management board and a supervisory board. The supervisory board appoints and dismisses members of the management board, supervises the management board, and reviews and approves annual financial statements. The KGaA is a mixture of the limited partnership and the corporate form of business organization. It must have at least one shareholder who is personally liable for the company's indebtedness (the remaining shareholders are liable only to the extent of their investments in the company). KGaAs are unknown in English-speaking countries. GmbHs are privately held companies. Most medium and small businesses operate in this form.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

EXHIBIT 3-4 Audit Opinion on BMW Group Financial Statements

In our opinion, based on the findings of our audit, the consolidated financial statements comply with IFRS, as adopted by the EU, the additional requirements of German Commercial Law pursuant to §315a (1) HGB and give a true and fair view of the net assets, financial position, and results of operations of the Group. The Group Management Report is consistent with the consolidated financial statements and as a whole provides a suitable view of the Group's position and suitably presents the opportunities and risks of future development.

Munich, 27 February 2009
KPMG AG

Source: 2008 BMW Annual Report, p. 133.

Small companies are exempt from the audit requirement and may prepare an abbreviated balance sheet. Small and medium-sized companies may prepare abbreviated income statements. These companies also have fewer disclosure requirements for their notes. A cash flow statement and a statement of changes in owners' equity are required for consolidated financial statements but not individual company statements.

The notes section of the financial statements is usually extensive, especially for large companies. Disclosures include the accounting principles used, the extent to which results are affected by claiming tax benefits, unaccrued pension obligations, sales by product line and geographic markets, unaccrued contingent liabilities, and average number of employees. The management report describes the financial position and business developments during the year, important post-balance sheet events, anticipated future developments, and research and development activities. Publicly traded companies are required to provide additional segment disclosures. They must also provide abbreviated half-yearly financial statements that are reviewed by an auditor and accompanied by an interim management report.

A feature of the German financial reporting system is a private report by the auditors to the company's managing board of directors and supervisory board. This report comments on the company's future prospects and, especially, factors that may threaten its survival. The auditor must describe and analyze items on the balance sheet that have a material impact on the company's financial position. The auditor also has to evaluate the consequences of and pass judgment on all significant accounting choices. This report can run several hundred pages for large German companies. As noted, it is private information, not available to shareholders.

Consolidated financial statements are required for enterprises under unified management and with a majority of voting rights, dominant influence by virtue of control contracts, or the right to appoint or remove a majority of the board of directors. For purposes of consolidation, all companies in the group must use identical accounting and valuation principles. However, they need not be the same as those used in individual company statements. In this way, tax-driven accounting methods in individual accounts can be eliminated in the group accounts. Consolidated accounts are not the basis for either taxation or profit distributions.

All companies, not just listed ones, may use IFRS in preparing their consolidated financial statements. However, individual company financial statements must follow

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

HGB requirements. Companies also have the option of publishing individual company financial statements according to IFRS for informational purposes.

ACCOUNTING MEASUREMENTS Under the Commercial Code (HGB), the purchase (acquisition) method is used for business combinations. Until 2009, two forms of the purchase method were permitted: the book-value method and the revaluation method (they essentially differed in the treatment of minority interests).[20] Now, the revaluation method must be used whereby assets and liabilities of acquired enterprises are brought up to current value, and any amount left over is goodwill. Goodwill must be amortized over its useful life, normally five years or less. The equity method is used for associates that are owned 20 percent or more, but only in consolidated financial statements. Joint ventures may be accounted for using either proportional consolidation or the equity method. The modified closing rate method is used for foreign currency translation (see Chapter 8).

GAS are somewhat different than the HGB regarding consolidated financial statements. Under GAS 4, the revaluation method must be used, whereby assets and liabilities acquired in a business combination are revalued to fair value, and any excess allocated to goodwill. Goodwill is tested annually for impairment. GAS 14 adopts the functional currency approach to foreign currency translation, in line with IFRS, as previously described.

Historical cost is the basis for valuing tangible assets. (Germany is one of the world's staunchest adherents to the historical cost principle. Its strong anti-inflation attitudes are the result of the ravages of the two debilitating inflationary periods it went through in the 20th century.) Inventory is stated at the lower of cost or market; FIFO, LIFO, and average are acceptable methods of determining cost. Depreciable fixed assets are subject to tax depreciation rates.

Research and development costs are expensed when incurred. Finance leases typically are not capitalized, but pension obligations are accrued based on their actuarially determined present value consistent with tax laws. Deferred taxes do not normally arise in individual company accounts, because these are consistent with tax law. However, they may arise in consolidated statements if accounting methods used for consolidations are different from those used for the individual accounts. In this case, deferred taxes must be set up using the liability method.

Provisions as estimates of future expenses or losses are used heavily. Provisions must be set up for deferred maintenance expenses, product guarantees, potential losses from pending transactions, and other uncertain liabilities. Optional provisions, such as those for future major repairs, are also allowed. Most companies make provisions as large as possible because legally booked expenses directly affect the determination of taxable income. Provisions give German companies many opportunities to manage income. Portions of retained earnings often are allocated to specific reserves, including a mandated legal reserve and those resulting from the provisions just described.

As noted earlier, listed German companies must prepare their consolidated financial statements in accordance with IFRS. Other companies have a choice of using either

[20] Dieter Ordelheide, "Germany: Group Accounts," in *Transnational Accounting*, ed. Dieter Ordelheide (London: Macmillan Press, 1995): 1599–1602.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

IFRS or German rules already described for consolidation purposes. Both choices are found in practice, and the reader of German financial statements should be careful to know which accounting standards are being followed.

Czech Republic

The Czech Republic (CR) is located in Central Europe with Germany to the west and northwest, Austria to the south, the Slovak Republic to the east, and Poland to the north. Its territory was a part of the Austro-Hungarian Empire for nearly 300 years (from 1620 to 1918), ruled by the Austrian monarchy, the Hapsburgs. The empire collapsed at the end of World War I, and the independent nation of Czechoslovakia was founded in 1918. Between the two world wars, Czechoslovakia was a prosperous parliamentary democracy with universal voting rights. This ended in 1938, when Britain and France allowed Nazi Germany to annex Czechoslovakia's ethnically German border territories. Within a year, Hitler controlled the rest of the nation and the Nazi occupation began. After the end of World War II, the 1946 elections and subsequent political maneuvering brought the Communist Party to power. This began the Soviet Union's domination over Czechoslovakia, which lasted until 1989. The internal disintegration of the Soviet regime and the collapse of the Czechoslovak Communist government in that year led to the so-called Velvet Revolution and the establishment of a new government. In 1993 Czechoslovakia peacefully split into two nations, the Czech Republic and the Republic of Slovakia.

Accounting in the Czech Republic has changed direction several times, reflecting the country's political history. Accounting practice and principles reflected those of the German-speaking countries of Europe until the end of World War II. Then, with the construction of a centrally planned economy, accounting practice was based on the Soviet model. The administrative needs of various central government institutions were satisfied through such features as a uniform chart of accounts, detailed accounting methods, and uniform financial statements, obligatory for all enterprises. A focus on production and costing, based on historical costs, was emphasized over external reporting. A unified system of financial and cost accounting used the same pricing and other principles.

Of course, prices did not reflect the market forces of supply and demand. They were centrally determined and controlled, primarily on a *cost plus* basis. Losses were normally subsidized. Accounting was of limited importance in managing an enterprise. Furthermore, accounting information was considered to be secret and financial statements were not published. While accounting information was inspected, it was not independently audited.[21]

After 1989 Czechoslovakia moved quickly toward a market-oriented economy. The government revamped its legal and administrative structure to stimulate the economy and attract foreign investments. Commercial laws and practices were adjusted to fit Western standards. Price controls were lifted. Accounting again turned westward, this time reflecting the principles embodied in the European Union Directives.

The division of Czechoslovakia did not appreciably affect this process. In 1993 the Prague Stock Exchange began regular operations. Considering the high level of

[21] Rudolf Schroll, "The New Accounting System in the Czech Republic," *European Accounting Review* 4, No. 4 (1995): 827–832; Jan Dolezal, "The Czech Republic," in *European Accounting Guide*, 2nd ed., ed. David Alexander and Simon Archer (San Diego: Harcourt Brace Jovanovich, 1995).

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

economic and political development achieved in pre-1938 Czechoslovakia, these events were more a matter of returning to previously held norms than discovering new ones.[22]

Privatization of the economy involved the return of property to former owners, small privatizations in which more than 20,000 shops, restaurants, and other small businesses were sold to Czech citizens at public auction, and a series of large privatizations. A key element of the latter was a coupon voucher system allowing adult Czech citizens to buy investment vouchers for a nominal price. These vouchers were used to acquire shares of newly privatized large industrial concerns. However, many Czechs, with no experience as shareholders, sold their shares to investment funds owned by state-controlled Czech banks. One result was a conflict of interest for the banks, which ended up owning the same companies to which they were lending money. A second round of privatizations involved auctions or direct sales, often to the companies' own managers. Many of these newly privatized businesses subsequently failed, leaving little or no collateral and overloading the court system with business cases. Both waves of privatization are now viewed as a mistake of trying to do too much at once.[23] A few remaining state-owned enterprises are still to be privatized. The economic reforms are ongoing. Among the more pressing issues are improving the openness and transparency of stock market operations through tighter regulations, and restructuring enterprises.[24]

In 1995 the Czech Republic became the first post-Communist member of the Organization for Economic Cooperation and Development (OECD). The Czech Republic joined NATO in 1999 and the European Union in 2004.[25]

ACCOUNTING REGULATION AND ENFORCEMENT The new Commercial Code was enacted by the Czech parliament in 1991 and became effective on January 1, 1992.[26] Influenced by the Austrian roots of the old commercial code and modeled on German commercial law, it introduced a substantial amount of legislation relating to businesses. (Czech law is based on the civil code law system of continental Europe.) This legislation includes requirements for annual financial statements, income taxes, audits, and shareholders meetings.

---

[22] Willie Seal, Pat Sucher, and Ivan Zelenka, "The Changing Organization of Czech Accounting," *European Accounting Review* 4, No. 4 (1995): 667.

[23] The first wave of coupon privatization occurred in 1992 and involved 1,491 state-owned companies. The second round ended in 1994, privatizing a further 861 companies.

[24] U.S. Department of State, "Background Notes: Czech Republic" (July 2008); U.S. Central Intelligence Agency, "The World Factbook—Czech Republic" (May 2009); Daniel Michaels and John Reed, "Halfway There," *Wall Street Journal Interactive Edition* (September 18, 1997): 1–6; Mark Andress, "Czech, Please!," *Accountancy* (September 2000): 60–61; Zuzana Kawaciukova, "Privatization Theft," *Prague Post Online* (July 24, 2003).

Czech capital markets are largely illiquid. In 1995 and 1996, after the initial large privatizations, there were over 1,600 Czech companies listed on the Prague Stock Exchange. However, in 1997 the exchange started delisting securities that were rarely traded. By the end of 1999, the Prague Stock Exchange had approximately 200 listed companies and there were 29 at the end of 2008. The Czech stock market is not seen as a place to raise new capital. For example, there have only been five initial public offerings of shares since it began operations in 1993 through the end of 2008. Transparent reporting, tight regulations, investor protection, and judicial enforcement are still lacking. See Pat Sucher, Peter Moizer, and Marcela Zarova, "The Images of the Big Six Audit Firms in the Czech Republic," *European Accounting Review* 8, no. 3 (1999): 503, 519; "After the Chaos: A Survey of Finance in Central Europe," *Economist* (September 14, 2002): 5–7, 10–11.

[25] The Czech Republic is not expected to adopt the euro until after 2012. Some experts predict that euro adoption may even be as late as 2014 or 2015.

[26] In 1991 legislation was passed by the then Czechoslovak parliament. The Czech Republic carried forward its provisions after the division.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

The Accountancy Act, which sets out the requirements for accounting, was passed in 1991 and became effective on January 1, 1993. Based on the EU's Fourth and Seventh Directives, the act specifies the use of a chart of accounts for record keeping and the preparation of financial statements.[27] It was significantly amended with effect from January 1, 2002 and 2004, primarily to bring Czech accounting closer to IFRS. The Ministry of Finance is responsible for accounting principles. Ministry of Finance decrees set out acceptable measurement and disclosure practices that companies must follow. Thus, accounting in the CR is influenced by the Commercial Code, the Accountancy Act, and Ministry of Finance decrees. The stock exchange has so far had little influence, and, despite the German origins of the Commercial Code, tax legislation is not directly influential. As discussed in the following section, the true and fair view embodied in the Accountancy Act and taken from EU Directives is interpreted to mean that tax and financial accounts are treated differently.[28] Nevertheless, legal form takes precedence over economic substance in some cases. The Ministry of Finance also oversees the Czech Securities Commission, responsible for supervising and monitoring the capital market and enforcing the Securities Act.

Auditing is regulated by the Act on Auditors, passed in 1992. This act established the Chamber of Auditors, a self-regulated professional body that oversees the registration, education, examination, and disciplining of auditors, the setting of auditing standards, and the regulation of audit practice, such as the format of the audit report. An audit of financial statements is required for all corporations (joint stock companies) and for large limited liability companies (those exceeding two of the following three criteria: turnover of CzK80 million, net assets of CzK40 million, 50 employees).[29] The audit is designed to assure that the accounts have been kept according to applicable legislation and decrees and that the financial statements present a true and fair view of the company's financial position and results. The Chamber of Auditors has adopted International Standards on Auditing (see Chapter 8). The chamber is overseen by the Audit Public Oversight Council, established in 2009.

FINANCIAL REPORTING Financial statements must be comparative, consisting of:

1. Balance sheet
2. Profit and loss account (income statement)
3. Notes

Consistent with the requirements of the EU Directives, the notes include a description of the accounting policies and other relevant information for assessing the financial statements. Examples of the latter include employee information, revenues by segment, and contingencies. The notes must also include a cash flow statement. Consolidated financial statements are required for groups meeting at least two of the following criteria: (1) assets of CzK350 million, (2) revenues of CzK700 million, and (3) 250 employees. Controlling interest in a subsidiary is based on either owning a majority of shares or

---

[27] Charts of accounts are not new to the Czech Republic because their use was required under communism. The Czechs based their new system on the French Plan Comptable and received substantial help from the French Ministry of Finance and the French accounting profession in developing their new charts of account.
[28] Pat Sucher, Willie Seal, and Ivan Zelenka, "True and Fair View in the Czech Republic: A Note on Local Perceptions," *European Accounting Review* 5, No. 3 (1996): 551.
[29] Corporations issue shares, whereas limited liability companies do not. The latter are similar to limited partnerships.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

having a direct or indirect dominant influence. Small and other companies not subject to audit have abbreviated disclosure requirements. Financial statements are approved at the annual meeting of shareholders. Listed Czech companies must use IFRS for both their consolidated and individual company financial statements. Nonlisted companies have the option of using IFRS or Czech accounting standards for their consolidated statements, but must use Czech standards in their individual company statements. Listed companies are also required to present quarterly income statements.

ACCOUNTING MEASUREMENTS The acquisition (purchase) method is used to account for business combinations. Goodwill arising from a business combination is written off in the first year of consolidation or capitalized and amortized over no more than 20 years. The equity method is used for associated companies (those over which the company exercises significant influence but which are not consolidated), and proportional consolidation is used for joint ventures.[30] The year-end (closing) exchange rate is used to translate both the income statement and balance sheet of foreign subsidiaries. There are no guidelines for reporting foreign currency translation adjustments.

Tangible and intangible assets are valued at cost and written off over their expected economic lives. Inventory is valued at the lower of cost or net realizable value, and FIFO and weighted average are allowable cost-flow assumptions (LIFO is not). Research and development costs may be capitalized if they relate to projects completed successfully and capable of generating future income. Leased assets are typically not capitalized—an example of form over substance. Deferred income taxes are provided in full for all temporary differences. Contingent losses are recorded when they are probable and can be reliably measured. Companies may also take provisions for future repairs and maintenance expenditures. Legal reserves are required: Profits are appropriated annually until they reach 20 percent of equity for corporations and 10 percent for limited liability companies.

The Netherlands

Dutch accounting presents several interesting paradoxes. The Dutch have relatively permissive statutory accounting and financial reporting requirements but very high professional practice standards. The Netherlands is a code law country, yet accounting is oriented toward fair presentation. Financial reporting and tax accounting are two separate activities. Further, the fairness orientation developed without a strong stock market influence. The United Kingdom and the United States have influenced Dutch accounting as much (or more) than other continental European countries. Unlike the norm elsewhere in continental Europe, the accounting profession has had a significant influence on Dutch accounting standards and regulations.[31]

---

[30] In individual company statements, either the equity or cost method may be used to account for associated companies.

[31] The idea that the business community is capable of adequate financial reporting is well entrenched in Dutch thinking. The first limited liability companies were formed in the 17th century without a clear legal framework on the matter. The first commercial code, introduced in the 19th century, viewed shareholders as responsible for management, which prompted little need for extensive accounting requirements in the law. As in the United Kingdom, the Dutch accounting profession emerged in the 19th century and has had a substantial influence on accounting. By the time an income tax on corporations was introduced (in 1940), financial reporting was already too well developed to be dominated by tax accounting. See Kees Camfferman, "The History of Financial Reporting in the Netherlands," in *European Financial Reporting: A History*, ed. Peter Walton (London: Academic Press, 1995).

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

Accounting in the Netherlands is considered a branch of business economics.[32] As a result, much economic thought has been devoted to accounting topics and especially to accounting measurements. Highly respected professional accountants are often part-time professors. Thus, academic thought has a major influence upon ongoing practice.

Dutch accountants are also willing to consider foreign ideas. The Dutch were among the earliest proponents of international standards for financial accounting and reporting, and the statements of the IASB receive substantial attention in determining acceptable practice. The Netherlands is also home to several of the world's largest multinational enterprises, including Philips, Royal Dutch Shell, and Unilever.[33] These enterprises have been internationally listed since the 1950s and have been influenced by foreign (particularly U.K. and U.S.) accounting. Through example, these large multinationals have influenced the financial reporting of other Dutch companies. The influence of the Amsterdam Stock Exchange, however, has been minimal because it does not provide much new business capital.

ACCOUNTING REGULATION AND ENFORCEMENT Accounting regulations in the Netherlands remained liberal until the passage of the Act on Annual Financial Statements in 1970. The act was a part of an extensive program of changes in company legislation and was introduced partly to reflect the coming harmonization of company law within the EU. Among the major provisions of the 1970 act are the following:

- Annual financial statements shall show a fair picture of the financial position and results of the year, and all items therein must be appropriately grouped and described.
- Financial statements must be drawn up in accordance with sound business practice (i.e., accounting principles acceptable to the business community).
- The bases of stating assets and liabilities and determining results of operations must be disclosed.
- Financial statements shall be prepared on a consistent basis, and the material effects of changes in accounting principles must be properly disclosed.
- Comparative financial information for the preceding period shall be disclosed in the financial statements and accompanying footnotes.

The 1970 act introduced the mandatory audit. It also set into motion the formation of the Tripartite Accounting Study Group[34] and gave birth to the Enterprise Chamber. The act, incorporated into the civil code in 1975, was amended by legislation in 1983 to incorporate the EU Fourth Directive, and further amended in 1988 to incorporate the EU Seventh Directive.

[32] Refer to the microeconomic approach to accounting development discussed in Chapter 2.
[33] Unilever is a binational (British and Dutch) concern. Royal Dutch Shell is headquartered in the Netherlands but incorporated in Britain.
[34] The Tripartite Accounting Study Group was replaced in 1981 by the Council on Annual Reporting (CAR). The CAR changed its name to the Dutch Accounting Standards Board in 2005.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

The Dutch Accounting Standards Board (DASB) issues guidelines on generally acceptable (not accepted) accounting principles.[35] The board is composed of members from three different groups:

1. Preparers of financial statements (employers)
2. Users of financial statements (representatives of trade unions and financial analysts)
3. Auditors of financial statements[36]

The DASB is a private organization financed by grants from the business community and the auditing profession. Its activities are coordinated by the Foundation for Annual Reporting (FAR). FAR appoints the members of the DASB and ensures adequate funding. Even though the board's guidelines do not have the force of law, they have traditionally been followed by most companies and auditors.[37] The guidelines are comprehensive in scope and incorporate as far as possible the standards of the IASB. (As an aid in drafting new or revised guidelines, the DASB uses a conceptual framework that is a translation of the IASB framework.) Nevertheless, the only legally enforceable accounting rules are those specified in the accounting and financial reporting provisions of the Dutch civil code. Before 2005, the DASB had a strategy to implement changes in IFRS into its own standards. But this strategy changed as a result of the EU regulations requiring IFRS for listed companies. The current strategy of the DASB is to focus on reporting standards for nonlisted companies.

The Netherlands Authority for the Financial Markets (AMF) supervises the operations of the securities markets. Although it falls under the Ministry of Finance, the AMF is an autonomous administrative authority. Among the responsibilities given it in 2006 is the oversight of annual reporting and auditing of listed companies. Its Financial Reporting Supervision Division examines financial statements filed with the AMF to ensure that they comply with applicable standards and the law. Its Audit Firm Oversight Division ensures that applicable audit standards are followed. The 2006 Supervision of Auditors' Organizations Act also provides for AMF oversight of the audit profession.

The Enterprise Chamber, a specialist court connected with the High Court of Amsterdam, is a unique feature of the Dutch system of enforcing compliance with accounting requirements. Any interested party may complain to this chamber if it believes that a company's financial statements do not conform to applicable law. Shareholders, employees, trade unions, and even the public prosecutor (but not independent auditors) may bring proceedings to the chamber. The chamber is composed of three judges and two expert accountants, and there is no jury. Chamber decisions may lead to modifications of financial statements or various penalties. Even though the rulings apply only to defendant companies, they sometimes state general rules that may influence the reporting practices of other companies.

Auditing is a self-regulated profession in the Netherlands. Its governing body is the Netherlands Institute of Registeraccountants (NIvRA), which has approximately 14,000 members.[38] It is autonomous in setting auditing standards, and its strong professional code of conduct has statutory status.

---

[35] The DASB Web site is www.rjnet.nl.
[36] Neither the Amsterdam Stock Exchange nor shareholder representatives participate in the board.
[37] However, auditors can issue an unqualified opinion when there is noncompliance with a guideline, as long as the financial statements still convey a true and fair view.
[38] The NIvRA Web site is www.nivra.nl.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

Until 1993, only members of NIvRA could certify financial statements, but changes were made that year to incorporate the EU Eighth Directive. In the Netherlands there are two kinds of auditors: registeraccountants (RAs, or chartered accountants) and administrative accountants (AAs).[39] The 1993 changes allowed AAs to also certify financial statements if they undergo additional training. Over time, educational and training qualifications for RAs and AAs will be standardized, and the code of conduct will be the same in relation to audit work, the auditor's responsibilities, and independence. One set of disciplinary rules will apply. However, NIvRA is likely to continue to dominate auditing and accounting in the Netherlands.

NIvRA is involved in everything that is accounting related in the Netherlands. It participates in the Dutch Accounting Standards Board and in commissions charged with revising the accounting statutes of the civil code. NIvRA members serve on the Enterprise Chamber, as accounting faculty at leading Dutch universities, on the IASB, and on committees of the EU, the OECD, the UN, and the International Federation of Accountants.

FINANCIAL REPORTING The quality of Dutch financial reporting is uniformly high. Statutory financial statements should be filed in Dutch, but English, French, and German are also acceptable. The financial statements must include the following:

1. Balance sheet
2. Income statement
3. Notes
4. Directors' report
5. Other prescribed information

A cash flow statement is required for large and medium-sized companies. The notes must describe the accounting principles used in valuation and the determination of results, and the reasoning behind any accounting changes. The directors' report reviews the financial position at the balance sheet date, and performance during the financial year. It also provides information about the expected performance during the new financial year and comments on any significant post-balance sheet events. "Other prescribed information" must include the auditor's report and profit appropriations for the year.

Annual financial reports must be presented on both a parent-company-only and a consolidated basis. Group companies for the purpose of consolidation are companies that form an economic unit under common control. Consistent with EU Directives, reporting requirements vary by company size. Small companies are exempt from the requirements for an audit and for consolidated financial statements, and they may file an abbreviated income statement and balance sheet. Medium-sized companies must be audited, but may publish a condensed income statement. Small, medium-sized, and large companies are defined in the civil code. Listed Dutch companies must prepare IFRS consolidated statements. Their parent-company statements may also be prepared

[39] The Nederlandse Orde van Accountants-Administratieconsultenen (NovAA) Web site is www.novaa.nl.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

using IFRS, Dutch accounting guidelines, or a mixture of the two. All Dutch companies are allowed to use IFRS instead of Dutch guidelines.

ACCOUNTING MEASUREMENTS Although the pooling-of-interests method of accounting for business combinations is allowed in limited circumstances, it is rarely used in the Netherlands. The purchase method is the normal practice. Goodwill is the difference between the acquisition cost and the fair value of the assets and liabilities acquired. It is normally capitalized and amortized over its estimated useful life, up to a maximum of 20 years. It may also be charged immediately to shareholders' equity or to income. The equity method is required when the investor exercises significant influence on business and financial policy. Joint ventures may be accounted for using either the equity method or proportional consolidation. Foreign currency translation is similar to IFRS. The balance sheet of a "foreign entity" is translated at the closing (year-end) rate, while the income statement is translated at the closing or average rate. Translation adjustments are charged to shareholders' equity. The temporal method is used for "direct foreign activities," with the translation adjustment charged to income.

The Dutch flexibility toward accounting measurements is most evident in permitting the use of current values for tangible assets such as inventory and depreciable assets. When current values are used for these assets, their corresponding income-statement amounts, cost of goods sold and depreciation, are also stated at current values. Current value can be replacement value, recoverable amount, or net realizable value. Current value accounting is expected to be consistently applied; piecemeal revaluations normally are not allowed. Revaluations are offset by a revaluation reserve in shareholders' equity. Companies using current values should provide additional historical cost information in the notes. Historical cost is also acceptable. While much has been made of current value accounting in the Netherlands, few companies actually use it. Philips, arguably the most conspicuous example, started using current value accounting in 1951, but abandoned it in 1992 in the interests of international comparability. Nevertheless, current values have a place in Dutch accounting because companies that use historical cost for the balance sheet and income statement are expected to disclose supplemental current cost information in their notes. Current cost accounting is discussed in detail in Chapter 7.

When historical cost is used for inventory, it is generally stated at the lower of cost or net realizable value, with cost determined by FIFO, LIFO, or average methods. All intangibles are assumed to have a finite life, normally no more than 20 years, and are amortized over that life. Intangibles with lives longer than 20 years must be impairments tested each year. Research and development costs are capitalized only when the amounts are recoverable and sufficiently certain. Leases, contingencies, and pension costs are generally measured as they are in the United Kingdom and United States, although the applicable rules are more general. Deferred income taxes are recognized on the basis of the comprehensive allocation concept (full provision) and measured according to the liability method. They may be valued at discounted present value. Current value accounting is not acceptable for tax purposes, so when current values are used for financial reporting, permanent rather than temporary differences arise.

Because Dutch companies have flexibility in applying measurement rules, one would suspect that there are opportunities for income smoothing. In addition, there is

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

flexibility in providing for probable future obligations. For example, provisions for periodic maintenance and major overhauls are allowed.[40]

United Kingdom

Accounting in the United Kingdom developed as an independent discipline, pragmatically responding to the needs and practices of business.[41] Over time, successive companies laws added structure and other requirements, but still allowed accountants considerable flexibility in the application of professional judgment. Since the 1970s, the most important source of development in company law has been the EU Directives, most notably the Fourth and Seventh Directives. At the same time, accounting standards and the standard-setting process have become more authoritative.

The legacy of British accounting to the rest of the world is substantial. The United Kingdom was the first country in the world to develop an accountancy profession as we know it today.[42] The concept of a fair presentation of financial results and position (the true and fair view) is also of British origin. Professional accounting thinking and practice were exported to Australia, Canada, the United States, and other former British possessions including Hong Kong, India, Kenya, New Zealand, Nigeria, Singapore, and South Africa.

ACCOUNTING REGULATION AND ENFORCEMENT The two major sources of financial accounting standards in the United Kingdom are companies law and the accounting profession. Activities of companies incorporated in the United Kingdom are broadly governed by statutes called companies acts. Companies acts have been updated, extended, and consolidated through the years. For example, in 1981 the EU Fourth Directive was implemented, adding statutory rules regarding formats, accounting principles, and basic accounting conventions. This introduced standardized formats for financial statements into Britain for the first time. Companies may choose from alternative balance sheet formats and four profit and loss account formats. The 1981 act also sets out five basic accounting principles:

1. Revenues and expenses are matched on an accrual basis.
2. Individual asset and liability items within each class of assets and liabilities are valued separately.
3. The principle of conservatism (prudence) is applied, especially in the recognition of realized income and all known liabilities and losses.
4. Consistent application of accounting policies from year to year is required.
5. The going concern principle is applicable to the entity being accounted for.

---

[40] For evidence that Dutch firms use provisions to smooth earnings, see Erik Peek, “The Use of Discretionary Provisions in Earnings Management,” *Journal of International Accounting Research* 3, no. 2 (2004): 27–43.

[41] The United Kingdom of Great Britain and Northern Ireland is a union of England, Scotland, Wales, and Northern Ireland. Even though the United Kingdom has an integrated system of laws, monetary and fiscal policies, and social rules and regulations, important individual differences remain among these four countries. The term “Britain” is often used for the United Kingdom. “British,” “Anglo,” and “Anglo-Saxon” are often used interchangeably to describe accounting in the United Kingdom.

[42] The first recognized accounting society was the Society of Accountants in Edinburgh, which was granted a royal charter in 1854. Similar societies were officially recognized in Glasgow in 1855 and in Aberdeen in 1867. Professional accounting began with these early professional societies. The United Kingdom has less than 1 percent of the world’s population, yet has more than 13 percent of its accountants. See Bob Parker, “Accountants Galore,” *Accountancy* (November 2001): 130–131.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

The act contains broad valuation rules in that the accounts may be based on either historical or current cost.

The Companies Act 1985 consolidated and extended earlier legislation and was amended in 1989 to recognize the EU Seventh Directive. This act requires the consolidation of financial statements, although consolidation was already standard practice.[43] The legal stipulations are general and allow considerable flexibility in case-by-case applications.

The following six accountancy bodies in the United Kingdom are linked through the Consultative Committee of Accountancy Bodies (CCAB), organized in 1970.[44]

1. The Institute of Chartered Accountants in England and Wales
2. The Institute of Chartered Accountants of Scotland
3. The Institute of Chartered Accountants in Ireland
4. The Association of Chartered Certified Accountants
5. The Chartered Institute of Management Accountants
6. The Chartered Institute of Public Finance and Accountancy

British standard setting evolved from recommendations on accounting principles (issued by the Institute of Chartered Accountants in England and Wales) to the 1970 formation of the Accounting Standards Steering Committee, later renamed the Accounting Standards Committee (ASC). The ASC promulgated Statements on Standard Accounting Practice (SSAPs). SSAPs were issued and enforced by the six accounting bodies, any one of which could effectively veto the standard. The veto power of these organizations often led to excessive delays and compromises in developing SSAPs. In addition, SSAPs were more in the nature of recommendations than compulsory requirements, and had little authority.

The Dearing Report, issued in 1988, expressed dissatisfaction with the existing standard-setting arrangement.[45] It recommended a new structure for setting accounting standards and more authoritative support for them. The Companies Act 1989 was important not only for incorporating the EU Seventh Directive but also for enacting the recommendations of the Dearing Report. The 1989 act created a new Financial Reporting Council (FRC) with the duty of overseeing its three offshoots: the Accounting Standards Board (ASB), which replaced the ASC in 1990, an Urgent Issues Task Force (UITF), and a Financial Reporting Review Panel.[46]

The FRC sets general policy. It is an independent body whose members are drawn from the accounting profession, industry, and financial institutions. The ASB has a full-time chair, a technical director, and up to eight paid part-time members, and is empowered to issue accounting standards. The ASB issues Financial Reporting Standards (FRSs) after considering comments on Discussion Papers and Financial Reporting Exposure Drafts (FREDs). The ASB is guided by a Statement of Principles for Financial Reporting, a conceptual framework for setting accounting standards.[47] The ASB also established the UITF to respond quickly to new problems and issue clarifications of the accounting

[43] The companies act is periodically updated, most recently in 2006.
[44] The Web site addresses are: CCAB: www.ccab.org.uk; ICAEW: www.icaew.com; ICAS: www.icas.org.uk; ICAI: www.icai.ie; ACCA: www.acca.co.uk; CIMA: www.cimaglobal.com; CIPFA: www.cipfa.org.uk.
[45] Sir Ron Dearing, (The Dearing Report) "The Making of Accounting Standards, Report of the Review Committee," presented to the Consultative Committee of Accountancy Bodies, 1988.
[46] Web sites are: Financial Reporting Council: www.frc.org.uk; Accounting Standards Board and Urgent Issues Task Force: www.frc.org.uk/asb/; Financial Reporting Review Panel: www.frc.org.uk/frrp.
[47] Work on the Statement of Principles began soon after the ASB was formed and was completed in 1999.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

standards and other regulations (called UITF Abstracts). Because listed British (and other EU) companies must now use IFRS in their consolidated financial statements, the ASB has turned its attention away from developing U.K. GAAP to gradually converging U.K. accounting standards with IFRS. Another major role of the ASB is partnering with the IASB and other standard setters in the development of IFRS.

The 1989 act enacted legal sanctions for companies that do not comply with accounting standards. Both the Financial Reporting Review Panel and the Department of Trade and Industry can investigate complaints about departures from accounting standards. They can go to court to force a company to revise its financial statements. Companies must adopt the accounting policies most appropriate to their specific circumstances in order to give a true and fair view, and they must regularly review their policies to ensure that they remain appropriate.

All but small limited liability companies must be audited. Of the six accountancy bodies listed earlier, only members of the first four are allowed to sign audit reports. The audit report affirms that the financial statements present a true and fair view and comply with the Companies Act 1985. For example, the opinion paragraph of PricewaterhouseCoopers on the 2008 financial statements of BG Group, the British natural gas company, is reproduced in Exhibit 3-5.

Until 2000, auditing standards were the responsibility of a board of the CCAB. In that year the Accountancy Foundation was set up to regulate and oversee the auditing profession. Following a review of the accounting profession by the Department of Trade and Industry in 2003, the Accountancy Foundation was dissolved and its functions transferred to the FRC. A newly established Professional Oversight Board (POB) oversees the regulation of the auditing profession by monitoring the activities of the professional accounting bodies, including education and training, standards, professional conduct, and discipline. The POB also oversees an independent Audit Inspection

EXHIBIT 3-5 Audit Opinion on BG Group Financial Statements

In our opinion:

- The Group Financial Statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of its profit and cash flows for the year then ended;
- The parent company Financial Statements give a true and fair view, in accordance with IFRSs as adopted by the European Union as applied in accordance with the provisions of the Companies Act 1985, as of the state of the parent company's affairs as at 31 December 2008 and cash flows for the year then ended; and
- The Financial Statements and the part of the remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and, as regards the Group Financial Statements, Article 4 of the IAS Regulation; and
- The information given in the Directors' Report is consistent with the Financial Statements.

PricewaterhouseCoopers LLP
11 March 2009

Source: 2008 BG Group Annual Report, p. 64.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

Unit (AIU), which monitors the audits of listed companies and other public interest entities. The Auditing Practices Board (APB) was transferred from the Accountancy Foundation to the FRC. It prescribes the basic principles and practices that an auditor must follow when conducting an audit, and is responsible for ethical standards and standards on audit independence. British auditing standards follow International Standards on Auditing. Finally, the Accountancy Investigation and Discipline Board (now the Accountancy and Actuarial Discipline Board, or AADB) was established as a mechanism to investigate and discipline accountants or accounting firms for professional misconduct. All of these reforms were designed to strengthen the accounting and audit profession, and provide a more effective system of regulation of the profession. Thus, the Financial Reporting Council has responsibility for both accounting and auditing standards, and their enforcement.[48]

FINANCIAL REPORTING British financial reporting is among the most comprehensive in the world. Financial statements generally include:

1. Directors' report
2. Profit and loss account and balance sheet
3. Cash flow statement
4. Statement of total recognized gains and losses
5. Statement of accounting policies
6. Notes referenced in the financial statements
7. Auditor's report

The directors' report addresses principal business activities, review of operations and likely developments, important post-balance sheet events, recommended dividends, names of the directors and their shareholdings, and political and charitable contributions. Listed companies must include a statement on corporate governance with disclosures on directors' remuneration, audit committees and internal controls, and a declaration that the company is a going concern. They must also report on social and environmental matters. Financial statements must present a true and fair view of a company's state of affairs and profits. To achieve this, additional information may be necessary, and in exceptional circumstances requirements may be overridden. The latter is known as the "true and fair override."[49]

Group (consolidated) financial statements are required in addition to a parent-only balance sheet. Control of subsidiary "undertakings" occurs when the parent has power to exercise dominant influence or control over the undertaking, or the parent and subsidiary are managed in a unified basis. The London Stock Exchange requires that listed companies provide half-year interim reports. Listed companies must also report basic and diluted earnings per share.

---

[48] The FRC was given the responsibility for setting actuarial standards and overseeing the actuarial profession in 2006.

[49] Research shows that the true and fair override has been used to mask poor performance and that its use has declined since the EU requirement for IFRS. See Gilad Livne and Maureen McNichols, "An Empirical Investigation of the True and Fair Override in the United Kingdom," *Journal of Business Finance and Accounting* (January/March 2009): 1–30.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

Another feature of U.K. financial reporting is that small and medium-sized companies are exempt from many financial reporting obligations. The Companies Act sets out size criteria. In general, small and medium-sized companies are permitted to prepare abbreviated accounts with certain minimum prescribed information. Small and medium-sized groups are exempt from preparing consolidated statements.

ACCOUNTING MEASUREMENTS The United Kingdom allows both the acquisition and merger methods of accounting for business combinations. However, the conditions for the use of the merger method (*pooling-of-interests* in the United States) are so narrow that it is almost never used. Under the acquisition method, goodwill is calculated as the difference between the fair value of the consideration paid and the fair value of the net assets acquired. FRS 7 specifies that fair values are assigned to identifiable assets and liabilities that exist at the date of acquisition, reflecting the conditions at that time. Future operating losses and reorganization costs cannot be considered in the calculation of goodwill, but must be reflected in post-acquisition income. Goodwill is capitalized and amortized over 20 years or less; however, a longer period or an indefinite period (resulting in no amortization) is possible if goodwill is subject to an annual impairment review. Proportional consolidation is only permitted for unincorporated joint ventures. The equity method is used for *associated* undertakings and for joint ventures that are companies. Foreign currency translation follows the requirements of IFRS, as discussed previously.

Assets may be valued at historical cost, current cost, or (as most companies do) using a mixture of the two. Thus, revaluations of land and buildings are permissible. Depreciation and amortization must correspond to the measurement basis used for the underlying asset. Research expenditures are written off in the year of the expenditure, and development costs may be deferred under specific circumstances. However, in practice, few British companies capitalize any development costs. Inventory (referred to as "stocks") is valued at the lower of cost or net realizable value on a FIFO or average cost basis; LIFO is not acceptable.

Leases that transfer the risks and rewards of ownership to the lessee are capitalized and the lease obligation is shown as a liability. The costs of providing pensions and other retirement benefits must be recognized systematically and rationally over the period during which the employees' services are performed. Contingent losses are accrued when they are probable and can be estimated with reasonable accuracy. Deferred taxes are calculated under the liability method on a full provision basis for most timing differences.[50] Long-term deferred tax balances may be valued at discounted present value. Income smoothing opportunities exist given the flexibility that exists in asset valuation and other measurement areas.

[50] Providing deferred taxes based on timing differences is not the same as the temporary-difference approach of IFRS and U.S. GAAP. The timing difference approach calculates deferred taxes when there are differences between accounting and taxable income, while the temporary difference approach calculates deferred taxes when there are differences between the accounting and tax carrying amounts of assets and liabilities. Thus, the former is an income statement approach and the latter is a balance sheet approach. All timing differences generate temporary differences, but the reverse isn't true. As a result, U.K. GAAP potentially provides for lower deferred taxes than would be calculated under IFRS and U.S. GAAP. The two main places causing such a divergence are (a) revaluations of assets and liabilities in a business acquisition without a corresponding change in their tax basis and (b) revaluations of nonmonetary assets credited to reserves (equity).

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

EXHIBIT 3-6 Summary of Significant Accounting Practices

	IFRS	France	Germany	Czech Republic	The Netherlands	United Kingdom
1. Business combinations: purchase or pooling	Purchase	Purchase[a]	Purchase	Purchase	Purchase[a]	Purchase[a]
2. Goodwill	Capitalize and impairments test	Capitalize and amortize	Capitalize and amortize[b]	Capitalize and amortize[b]	Capitalize and amortize[c]	Capitalize and amortize[d]
3. Associates	Equity method	Equity method	Equity method	Equity method	Equity method	Equity method
4. Asset valuation	Historical cost & fair value	Historical cost	Historical cost	Historical cost	Historical cost & fair value	Historical cost & fair value
5. Depreciation charges	Economic based	Tax based	Tax based	Economic based	Economic based	Economic based
6. LIFO inventory valuation	Not permitted	Not permitted	Permitted	Not permitted	Permitted	Not permitted
7. Probable losses	Accrued	Accrued	Accrued	Accrued	Accrued	Accrued
8. Finance leases	Capitalized	Not capitalized	Not capitalized	Not capitalized	Capitalized	Capitalized
9. Deferred taxes	Accrued	Not accrued	Not accrued	Accrued	Accrued	Accrued
10. Reserves for income smoothing	No	Used	Used	Some	Some	Some

[a] *Pooling also allowed in narrow circumstances, but not widely used.*

[b] *May also be written off to reserves.*

[c] *May also be written off to shareholders' equity or to income.*

[d] *Nonamortization permitted if subject to annual impairment review.*

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

All U.K. companies are permitted to use IFRS instead of U.K. GAAP just described. Thus, the EU 2005 initiative for listed companies is extended to nonlisted U.K. companies as well. In August 2009, the Accounting Standards Board issued a consultation paper setting out a roadmap for the replacement of U.K. GAAP with a new three-tiered reporting framework based on IFRS. Under the framework, all public companies will continue to apply full IFRS. Other companies, other than those classified as small, would use IFRS for SMEs (see Chapter 8) or full IFRS. Small companies would use U.K. Financial Reporting Standards for Smaller Entities.

Exhibit 3-6 summarizes the significant accounting practices in the countries surveyed in this chapter.

Discussion Questions

1. Compare and contrast the mechanisms for regulating and enforcing financial reporting in the five countries discussed in this chapter.
2. Compare and contrast the main features of financial reporting in the five countries discussed in this chapter.
3. Auditor oversight bodies have recently been established in several countries discussed in this chapter. Identify the auditor oversight bodies discussed in the chapter. What is the reason for this recent trend?
4. What is the difference between consolidated and individual company financial statements? Why do some EU countries prohibit IFRS in individual company financial statements while others permit or require IFRS at the individual company level?
5. Consider the following statement: "Experience shows that the needs of national and international markets, for international harmonization in particular, are better served by self-regulation and development than by government regulation." Do you agree? Why or why not?
6. In France, financial accounting standards and practices originate primarily from three authoritative sources: (a) companies legislation (Plan Comptable Général and Code de Commerce), (b) professional opinions and recommendations (CNC, CRC, OEC, and CNCC), and (c) stock exchange regulations (AMF). Which of these three has the greatest influence on day-to-day French accounting practice?
7. Consider the following statement: "The German Accounting Standards Committee is modeled on Anglo-American and international practice." Do you agree? Why or why not?
8. How have accounting requirements and practices in the Czech Republic been influenced by European Union requirements?
9. The most novel feature of the Dutch accounting scene is the Enterprise Chapter of the Court of Justice of Amsterdam. What is the mission of the Enterprise Chamber? How is this mission carried out?
10. A feature of British accounting is the "true and fair override." What is the meaning of this term? Why is the true and fair override found in the United Kingdom but almost nowhere else?

Exercises

1. This chapter provides synopses of national accounting practice systems in five European countries.

   Required: For each country, list:

   a. the name of the national financial accounting standard-setting board or agency.
   b. the name of the agency, institute, or other organization charged with supervising and enforcing financial accounting standards.
2. Refer to your answer to Exercise 1.

   Required: Which country discussed in this chapter appears to have the most effective

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

accounting and financial reporting supervision mechanism for companies whose securities are traded in public financial markets? Should each country that has a stock exchange (and therefore a public financial market) also have a regulatory agency that enforces accounting and financial reporting rules? Write a concise paragraph to support your answer.

3. The International Federation of Accountants (IFAC) is a worldwide organization of professional accounting bodies. IFAC's Web site (www.ifac.org) has links to a number of accounting bodies around the world.

Required: Visit IFAC's Web site. List the accounting organizations discussed in this chapter that are linked to IFAC's Web site.

4. Reread Chapter 3 and its discussion questions.

Required:

a. As you go through this material, prepare a list of five expressions, terms, or short phrases that are unfamiliar or unusual in your home country.

b. Write a concise definition or explanation of each item.

5. Analyze the five national accounting practice systems summarized in this chapter.

Required:

a. For each of the five countries discussed in this chapter, select the most important financial accounting practice or principle at variance with international norms.

b. For each selection you make, state briefly your reasons for its inclusion on your list.

c. How does this variance affect reported earnings and the debt to asset ratio?

d. How likely is it that an analyst could adjust for this variance to achieve an "apples to apples" comparison with companies from other countries?

6. Refer to Exhibit 3-6.

Required: Which country's GAAP appears to be the most oriented toward equity investors? Which country's GAAP appears to be the least oriented toward equity investors? Why do you say so?

7. The role of government in developing accounting and auditing standards differs in the five countries discussed in this chapter.

Required: Compare the role of government in developing accounting and auditing standards in France, Germany, the Czech Republic, the Netherlands, and the United Kingdom.

8. Countries of the European Union are establishing oversight bodies to regulate the activities of statutory auditors. These national bodies are also coordinated at the EU level.

Required: Find information on the European Group of Auditors' Oversight Bodies (EGAOB) on the European Union Web site (ec.europa.eu/internal_market/auditing/egaob). Discuss the role of the EGAOB. Identify the European countries with a public oversight body for auditing and name the country's related body.

9. In most countries, accounting standard setting involves a combination of private- and public-sector groups. The private sector includes the accounting profession and other groups affected by the financial reporting process, such as users and preparers of financial statements, and organized labor. The public sector includes government agencies, such as tax authorities, ministries responsible for commercial law, and securities commissions. The stock market is another potential influence.

Required: Complete a matrix indicating whether each of the above groups significantly influences accounting standard setting in the five countries discussed in this chapter. List the groups across the top and the countries down the side; indicate the influence of each group with a yes or a no.

10. Listed below are certain financial ratios used by analysts:

- *Liquidity:* current ratio; cash flow from operations to current liabilities
- *Solvency:* debt to equity; debt to assets
- *Profitability:* return on assets; return on equity

Required: Assume that you are comparing the financial ratios of companies from two countries discussed in this chapter. Discuss how the accounting practices identified in Exhibit 3-6 would affect your comparison for each of the six ratios in the list.

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

CASES

Case 3-1

Old Habits Die Hard

"The ethical climate in the Czech Republic has improved since the early days, but we still have a long way to go," said Josef Machinka, an economic adviser to the Ministry of Finance, while attending an investment seminar sponsored by the Prague Stock Exchange. "We really lack an established ethical framework."

Adds Charles University professor Jana Vychopeň, "Ethical problems still exist, but they stem from 40 years under a system that promoted corruption. Under the communists it was all political influence. There wasn't an economy—corruption sustained the system back then, but now chokes it. We were shocked into a market economy and our coupon privatization was racked with scandal. Even the word 'tunneling,' meaning asset stripping, was coined here."

"Ethics hangs over the market but so does a lack of transparency," states Pavel Kraus, analyst for Merta Investment Management. "Many of today's managers forged their attitudes in the 70s and 80s. Under communism, secrecy—not transparency—was the watchword. They just don't think it's important to keep investors informed, so how do you know they're not a bunch of shady managers trying to hide something?"

He goes on to give the example of Bednar, a large chemical company that was one of the first state-owned enterprises to be privatized. "Bednar is run by old dogs who can't—or won't—learn new tricks. Like a lot of Czech companies, Bednar didn't come to the stock market, but found itself on the stock exchange because of the privatization. The managers found themselves in a publicly traded company against their will.

"Still, it's better than the old days. Back in the 90s I asked to meet with them to discuss their business plan and was told, 'Sure—for CzK 400 an hour.' I kept phoning them for several weeks and finally wore them down. They ended up meeting me for free!"

Agreeing with Kraus is Jiři Michalik, a broker with Habova Securities. "Things are getting better. Czech companies are finally realizing that they have to let investors know what they're getting into if they are going to attract more investment. They looked around and realized that our Polish and Hungarian rivals were leaving us in the dust. Right after privatization most managers didn't have experience at quickly compiling and disseminating their financial information. Even if they had good intentions, it was hard for them to do. But now more and more of them have the experience."

The conversation comes back to Jana Vychopeň. "I put a lot of the blame on the Prague Stock Exchange. It's still not seen as a place to raise capital. Five IPOs between 1993 and 2008 is not a good track record. We have the rules in place and managers' attitudes are changing, if slowly. But poor enforcement means that investors don't always get what they need or they get it too late to be of any good. Of course, Czech citizens have never gotten used to being shareholders. They put most of their savings in banks, so banks have a lot of money to lend. It's easy for Czech

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

companies to get credit, so they have little incentive for going public."

Required

1. Describe the problems characterized in this case.
2. What are the likely causes of these problems?
3. What are consequences of these problems for investors, Czech companies, and the Prague Stock Exchange?
4. Outline a program of changes needed to correct the problems identified.

Case 3-2a

What Difference Does It Really Make?

As an analyst for a securities firm, you are aware that accounting practices differ around the world. Yet you wonder whether these differences really have any material effect on companies' financial statements. You also know that the SEC in the United States requires non-U.S. registrants to reconcile key financial data from the GAAP used in their financial statements to U.S. GAAP. However, companies using IFRS were exempt from this reconciliation requirement starting in 2007. You obtain the last reconciliation from sanofi-aventis (a French pharmaceutical company) in its 2006 Form 20F SEC filing [en.sanofi-aventis.com/binaries/20-F_2006_EN_tcm28-1518.pdf, pages F107-F120].

Required:

1. Document the effects of the GAAP differences in the 20F by doing the following:
   a. For the current year, calculate the percentage change for net income and for total shareholders' equity indicated by the reconciliation and using the non-U.S. GAAP (i.e., IFRS) numbers as a base.
   b. Repeat the same calculations for the preceding year. Are the percentage changes approximately the same? What is significant about your findings?
   c. For the current year, identify the two income statement items and the two balance sheet items that exhibit the relatively largest differences. Would you expect other French multinational companies to be subject to similar item-by-item differences?
2. Should a U.S. reader of non-U.S. financial statements find this SEC-mandated reconciliation useful?
3. Based on your analysis of the sanofi-aventis 2006 limited restatement, do you support the SEC's decision to exempt companies using IFRS from the reconciliation requirement? Why or why not?

To download more slides, ebook, solutions and test bank, visit http://downloadslide.blogspot.com

Case 3-2b

Do the Differences Really Matter?

As an analyst for a securities firm, you are aware that accounting practices differ around the world. Yet you wonder whether these differences really have any material effect on companies' financial statements. You also know that the SEC in the United States requires non-U.S. registrants to reconcile key financial data from the GAAP used in their financial statements to U.S. GAAP. However, companies using IFRS were exempt from this reconciliation requirement starting in 2007. You obtain the last reconciliation from Unilever (a Dutch consumer products company) in its 2006 Form 20F SEC filing [www.unilever.com/images/ir_06%20form-20F_tcm13-88525.pdf, pages 124–131].

Required

1. Document the effects of the GAAP differences in the 20F by doing the following:

a. For the current year, calculate the percentage change for net income and for total shareholders' equity indicated by the reconciliation and using the non-U.S. GAAP (i.e., IFRS) numbers as a base.

b. Repeat the same calculations for the preceding year. Are the percentage changes approximately the same? What is significant about your findings?

c. For the current year, identify the two income statement items and the two balance sheet items that exhibit the relatively largest differences. Would you expect other Dutch multinational companies to be subject to similar item-by-item differences?

2. Should a U.S. reader of non-U.S. financial statements find this SEC-mandated reconciliation useful?

3. Based on your analysis of the Unilever 2006 limited restatement, do you support the SEC's decision to exempt companies using IFRS from the reconciliation requirement? Why or why not?