

## DIVERSITY IN ACCOUNTING STANDARDS

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### Abstract

This paper investigates that the effect of Diversity in Accounting Standards in Nationally&Internationally. Neoclassical production to examine the capital market and welfare effects of a diversity in accounting standards (like IFRS).Firms vary in their cost of learning diverse standards for capital allocation. A uniform accounting standards increases the quality of the capital in the economy and lowers the cost of capital. However uniform standards force diverse firms onto the same standard which reduces same welfare. I draw implications for IFRS/GAAP convergence, and the incentives versus standards debate.

Keywords: Diversity in Accounting Standards, IFRS, GAAP. FASB. IASB.

### Introduction:

Over the last decade, the world has witnessed a slow but steady march toward convergence of international accounting standards. Many of countries around the globe already shifted to the international financial reporting standards (IFRS), and the securities exchange commission(SEC) has pledged to harmonize united states Generally Accepted Accounting Principles (USGAAP) with IFRS. Financial statements are prepared to summarize the end-result of all the

business activities by an enterprise during an accounting period in monetary terms. These business activities is vary from one enterprise to other. To compare

This report provides Considerable differences exist across countries in the accounting treatment of many items. For example, companies in the united states are not allowed report property , plant and equipment at amounts

Greater than historical cost. In contrast, companies in the european union are allowed to report their assets on the balance sheet at marked values. Research and development cost must be expensed as incurred in Japan, but development costs may be capitalized as an asset in Canada and France. Chinese companies are required to use the direct method in preparing the statement of cash flows, whereas most United States and Europe use the indirect method.

This paper critically examines, the effect of diversity in accounting standards. Difference in accounting can result in significantly different amounts being reported on the balance sheet and income statement. In its 2009 annual report , the south Korean telecommunication firm SK telecom company ltd. Described 15 significant differences between southern Korean and U.S. accounting rules. Under South Korean Generally Accepted Accounting Principles (GAAP), SK telecom reported

2009 net income of 1,056 billion South Korean won (KRW). if SK Telecom had U.S. GAAP in 2009, Its net income would have been KRW 1,357 billion, approximately 28 percent larger. Shareholders equity as stated under South Korean GAAP was KRW 12,345 billion but would have been KRW 14,261 billion under U.S GAAP, a 16 percent difference. Brazilian chemical company made 13 adjustments in 2009 to its Brazilian GAAP net income to report net income on a U.S GAAP basis. These adjustments casual Brazilian GAAP income of 767.8 million of Brazilian reais (BRL) to decrease by 70 percent, to 232.7 million under reais U.S. GAAP. Similarly , stockholders equity of BRS 4,592.5 of Brazilian GAAP basis to decreased to only 4,379.4 million under U.S. GAAP.

This paper presents of evidence of accounting diversity, explores the reasons for that diversity, and describes the problems that are created by differences in accounting practice across the countries. Historically several major models of accounting have been used internationally, with clusters of countries following them. These also are described and compared in this paper. We describe the potential impact that culture has had on the development of national accounting systems and present a simplified model of the reasons for international differences in financial reporting .

#### Evidence of Accounting Diversity

This paper provides evidence of accounting diversity for that we observe example-1 & example-2 of two companies consolidated balance sheets. For that we considered consolidated

balance sheets for British company Vodafone Group PLC and its U.S. competitor Verizon communication INC. A quick examination of these statements shows several differences in format and terminology between the United Kingdom and the United States. Perhaps the most obvious difference is the order in which assets are presented. Whereas Verizon presents assets in order of liquidity, starting with goodwill. On the other side of the Balance Sheet ,beginning with cash and cash equivalents, Vodafone presents assets in reverse order of liquidity , starting with Goodwill. On the other side of the balance sheet. Vodafone presents its equity account before liabilities. In the equity section , “ Called – up share capital “ is the equivalent of the common stock account on a balance sheet and “Share premium account” is the contributed capital in excess of par value. Vodafone uses a “ Capital redemption reserve “ to indicate an appropriation of retained earnings. Reserves are unknown in the United States. Vodafone includes “ Provisions “, which represent estimated liabilities related to restructurings, legal disputes, and asset retirements, in both current and non-current liabilities. This line item does not appear in the U.S. Balance sheet.

Common for U.S. companies, Verizon includes only consolidated financial statements in its annual report. In addition to consolidated financial statement, Vodafone also includes the parent company’s separate balance sheet in its annual report. This is shown in the following example-1.1. In the parent company Balance sheet, investments in subsidiaries are not consolidated but instead are reported as

Example-1

VODAFONE GROUP PLC

Consolidated Balance Sheets

Consolidated Balance Sheet at 31 March

	Note	2009 £m	2008 £m
<b>Non current Assets</b>			
Goodwill . . . . .	9	53,958	51,336
Other intangible assets. . . . .	9	20,980	18,995
Property, plant and equipment. . . . .	11	19,250	16,735
Investments in associated undertakings . .	14	34,715	22,545
Other investments . . . . .	15	7,060	7,367
Deferred tax assets. . . . .	6	630	436
Postemployment benefits. . . . .	26	8	65
Trade and other receivables . . . . .	17	3,069	1,067
		<hr/>	<hr/>
Total(I)		139,670	118,546
 <b>Current assets</b>			
Inventory . . . . .	16	412	417
Taxation recoverable . . . . .		77	57
Trade and other receivables . . . . .	17	7,662	6,551
Cash and cash equivalents . . . . .	18	4,878	1,699
		<hr/>	<hr/>
Total(II)		13,029	8,724
 <b>Total assets (I+II) . . . . .</b>			
		152,699	127,270

Equity			
Called-up share capital. . . . .	19	4,153	4,182
Share premium account. . . . .	21	43,008	42,934
Own shares held . . . . .	21	(8,036)	(7,856)
Additional paid-in capital . . . . .	21	100,239	100,151
Capital redemption reserve . . . . .	21	10,101	10,054
Accumulated other recognized income and expense . . . . .	22	20,517	10,558
Retained losses . . . . .	23	(83,820)	(81,980)
Total equity shareholders' funds. . . . .		86,162	78,043
Minority interests . . . . .		1,787	1,168
Written put options over minority interests . . . . .		(3,172)	(2,740)
Total minority interests . . . . .		(1,385)	(1,572)
		-----	
Total equity(III) . . . . .		84,777	76,471
Noncurrent liabilities			
Long-term borrowings . . . . .	25	31,749	22,662
Deferred tax liabilities. . . . .	6	6,642	5,109
Postemployment benefits. . . . .	26	240	104
Provisions. . . . .	27	533	306
Trade and other payables. . . . .	28	811	645
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Total(IV)		39,975	28,826
Current liabilities			
Short-term borrowings. . . . .	25, 35	9,624	4,532

Current taxation liabilities . . . . .		4,552	5,123
Provisions. . . . .	.27	373	356
Trade and other payables . . . . .	28	13,398	11,962
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Total(V)		27,947	21,973
Total equity and liabilities(III+IV+V) . . . . .		152,699	127,270

Example-2

VERIZON COMMUNICATIONS, INC.  
Consolidated Balance Sheets

At December 31 (Dollars in Millions) . . . . .		2009	2008
Assets			
Current assets			
Cash and cash equivalents . . . . .		\$ 2,009	\$ 9,782
Short-term investments . . . . .		490	509
Accounts receivable, net of allowances of \$976 and \$941 . . . . .		12,573	11,703
Inventories . . . . .		2,289	2,092
Prepaid expenses and other . . . . .		5,247	1,989
Total current assets. . . . .		22,608	26,075
Plant, property, and equipment . . . . .		228,518	215,605
Less accumulated depreciation. . . . .		137,052	129,059
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		91,466	86,546
Investments in unconsolidated businesses . . . . .		3,535	3,393

Wireless licenses . . . . .	72,067	61,974
Goodwill . . . . .	22,472	6,035
Other intangible assets, net . . . . .	6,764	5,199
Other investments . . . . .	—	4,781
Other assets. . . . .	8,339	8,349
Total assets . . . . .	\$227,251	\$202,352
Liabilities and Share owners' Investment		
Current liabilities		
Debt maturing within one year . . . . .	\$ 7,205	\$ 4,993
Accounts payable and accrued liabilities. . . . .	15,223	13,814
Other. . . . .	6,708	7,099
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Total current liabilities . . . . .	29,136	25,906
Long-term debt . . . . .	55,051	46,959
Employee benefit obligations . . . . .	32,622	32,512
Deferred income taxes . . . . .	19,310	11,769
Other liabilities. . . . .	6,765	6,301
Equity		
Series preferred stock (\$.10 par value; none issued) . . . . .	—	—
Common stock (\$.10 par value; 2,967,610,119 shares issued in both periods) . . . . .	297	297
Contributed capital . . . . .	40,108	40,291
Reinvested earnings . . . . .	17,592	19,250
Accumulated other comprehensive loss . . . . .	(11,479)	(13,372)
Common stock in treasury, at cost . . . . .	(5,000)	(4,839)

Deferred compensation—employee stock ownership plans and other . . . . .	88	79
Noncontrolling interest . . . . .	42,761	37,199
Total equity . . . . .	84,367	78,905
Total liabilities and equity . . . . .	\$227,251	\$202,352

Example-1.1

VODAFONE GROUP PLC  
Company Balance Sheets

Company Balance Sheet at 31 March

	Note	2009 £m	2008 £m
Fixed assets			
Shares in group undertakings. . . . .	3	64,937	64,922
Current assets			
Debtors: amounts falling due after more than one year . . . . .	4	2,352	821
Debtors: amounts falling due within one year . . . . .	4	126,334	126,099
Total debtors(I)		128,797	126,920
Cash at bank and in hand . . . . .		111	—
Creditors: amounts falling due within one year . . . . .		(92,339)	(98,784)
Net current assets . . . . .		36,458	28,136
Total assets less current liabilities . . . . .		101,395	93,058
Creditors: amounts falling due after more than one year. . . . .	5	(21,970)	(14,582)
Total(II)		79,425	78,476
Capital and reserves			

Called-up share capital. . . . .	6	4,153	4,182
Share premium account. . . . .	8	43,008	42,934
Capital redemption reserve . . . . .	8	10,101	10,054
Capital reserve . . . . .	8	88	88
Other reserves . . . . .	8	957	942
Own shares held . . . . .	8	(8,053)	(7,867)
Profit and loss account. . . . .	8	29,171	28,143
Equity shareholders' funds . . . . .		79,425	78,476

“Shares in group undertakings” in the “Fixed assets” section. Liabilities are called “Creditors” and receivables are “Debtors.” From the perspective of U.S. financial reporting, the UK parent company balance sheet has an unusual structure. Rather than the U.S. norm of Assets = Liabilities + Shareholders’ equity, Vodafone’s parent company balance sheet is presented as Assets – Liabilities = Shareholders’ equity . Closer inspection shows that the balance sheet presents the left-hand side of the equation as Non current assets + Working capital – Non current liabilities = Shareholders’ equity. All of these superficial differences would probably cause a financial analyst little problem in analyzing the company’s financial statements. More important than the format and terminology differences are the differences in recognition and measurement rules employed to value assets and liabilities and to calculate income. As was noted in the introduction to this chapter, very different amounts of net income and stockholders’ equity can be reported by a company depending

on the accounting rules that it uses. For example, SK Telecom’s 2009 net income was 28 percent larger under U.S. GAAP than under South Korean GAAP; Braskem’s 2009 net income was 70 percent smaller under U.S. GAAP than under Brazilian GAAP.

#### Reasons for providing Diversity

This paper observe and investigate on that why do financial reporting practices differ across the countries ? A survey of the relevant literature has identified the following five items as being commonly accepted as factors influencing a country’s financial reporting practices:

1. Legal System
2. Taxation
3. Providers of Financing
4. Inflation
5. Political & Economic Ties

There are two types of legal systems used around the world : Common Law and Codified Roman Law. Common law began in England and is primarily found in the English-speaking countries of the world. A system of code law, followed in most



non-English-speaking countries, originated in the Roman *jus civile* and was developed further in European universities during the Middle Ages.

## 2. Taxation

In some countries, published financial statements form the basis for taxation, whereas in other countries, financial statements are adjusted for tax purposes and submitted to the government separately from the reports sent to stockholders. Continuing to focus on Germany, the so-called congruency principle in that country stipulates that the published financial statements serve as the basis for taxable income.

## 3. Providers of Financing

The major providers of financing for business enterprises are family members, banks, governments, and shareholders. In those countries in which company financing is dominated by families, banks, or the state, there will be less pressure for public accountability and information disclosure. Banks and the state will often

## 4. Inflation

Countries experiencing chronic high rates of inflation found it necessary to adopt accounting rules that required the inflation adjustment of historical cost amounts. This was especially true in Latin America, which as a region has had more inflation than any other part of the

world. annual rate of inflation rate in Mexico was approximately

## 5. Political and Economic Ties

Accounting is a technology that can be relatively easily borrowed from or imposed on another country. Through political and economic links, accounting rules have been conveyed from one country to another.

## Correlation of Factors

Whether by coincidence or not, there is a high degree of correlation between legal system, tax conformity, and source of financing. As Example-3 shows, common law countries tend to have greater numbers of domestic listed companies, relying more heavily on equity as a source of capital. Code law countries tend to link taxation to accounting statements and rely less on financing provided by shareholders.

## PROBLEMS CAUSED BY ACCOUNTING DIVERSITY

### Preparation of Consolidated Financial Statements

The diversity in accounting practice across countries causes problems that can be quite serious for some parties. One problem relates to the preparation of consolidated financial statements by companies with foreign operations. Consider General Motors Corporation, which has subsidiaries in more than 50 countries around the world. Each subsidiary incorporated in the country in which it is located is required to prepare

financial statements in accordance with local regulations. These regulations usually require companies to keep books in local currency using local accounting principles. Thus, General Motors de Mexico prepares financial statements in Mexican pesos using Mexican accounting rules and General Motors Japan Ltd. prepares financial statements in Japanese yen using Japanese standards. To prepare consolidated financial statements in the United States, in addition to translating the foreign currency financial statements into U.S. dollars, the parent company must also convert the financial statements of its foreign operations into U.S. GAAP. Each foreign operation must either maintain two sets of books prepared in accordance with both local and U.S. GAAP or, as is more common, reconciliations from local GAAP to U.S. GAAP must be made at the balance sheet date. In either case, considerable effort and cost are involved; company personnel must develop an expertise in more than one country's accounting standards.

#### Access to Foreign Capital Markets

A second problem caused by accounting diversity relates to companies gaining access to foreign capital markets. If a company desires to obtain capital by selling stock or borrowing money in a foreign country, it might be required to present a set of financial statements prepared in accordance with the accounting standards in the country in which the capital is being obtained. Consider the case of

the semiconductor manufacturer STMicroelectronics, which is based in Geneva, Switzerland. The equity market in Switzerland is so small (there are fewer than 8 million Swiss) and ST's capital needs are so great that the company has found it necessary to have its common shares listed on the Euronext-Paris and Borsa

Italiana stock exchanges in Europe and on the New York Stock Exchange in the United States. To have stock traded in the United States, foreign companies must either prepare financial statements using U.S. accounting standards or provide a reconciliation of local GAAP net income and stockholders' equity to U.S. GAAP. This can be quite costly. In preparing for a New York Stock Exchange (NYSE) listing in 1993, the German automaker Daimler-Benz estimated it spent \$60 million to initially prepare U.S. GAAP financial statements; it expected to spend \$15 million to \$20 million each year thereafter. 9 The appendix to this chapter describes the case of Daimler-Benz in becoming the first German company to list on the NYSE. As noted in Chapter 1, the U.S. SEC eliminated the U.S. GAAP reconciliation

requirement for those foreign companies using IFRS to prepare their financial statements. However, foreign companies not using IFRS continue to provide U.S. GAAP information.

#### Comparability of Financial Statements

A third problem relates to the lack of comparability of financial statements

between companies from different countries. This can significantly affect the analysis of foreign financial statements for making investment and lending decisions. In 2003 alone, U.S. investors bought and sold nearly \$3 trillion worth of foreign stocks while foreign investors traded over \$6 trillion in U.S. equity securities. <sup>10</sup> In recent years there has been an explosion in mutual funds that invest in the stock of foreign companies. As an example, the number of international stock funds increased from 123 in 1989 to 534 by the end of 1995. <sup>11</sup> T. Rowe Price's New Asia Fund, for example, invests exclusively in stocks and bonds of companies located in Asian countries other than Japan. The job of deciding which foreign company to invest in is complicated by the fact that foreign companies use accounting rules different from those used in the United States and those rules differ from country to country. It is very difficult if not impossible for a potential investor to directly compare the financial position and performance of an automobile manufacturer in Germany (Volkswagen), Japan (Nissan), and the United States (Ford) because these three countries have different financial accounting and reporting standards. According to Ralph E. Walters, former chairman of the steering committee of the International Accounting Standards Committee, "either international investors have to be extremely knowledgeable about multiple reporting methods or they have to be willing to take greater risk." <sup>12</sup> A lack of comparability of

financial statements also can have an adverse effect on corporations when making foreign acquisition decisions. As a case in point, consider the experience of foreign investors in Eastern Europe. After the fall of the Berlin Wall in 1989, Western companies were invited to acquire newly privatized companies in Poland, Hungary, and other countries in the former communist bloc. The concept of profit and accounting for assets in those countries under communism was so different from accounting practice in the West that most Western investors found financial statements useless in helping to determine which enterprises were the most attractive acquisition targets. In many cases, the international public accounting firms were called on to convert financial statements to a Western basis before acquisition of a company could be seriously considered. There was a very good reason why accounting in the communist countries of Eastern Europe and the Soviet Union was so much different from accounting in capitalist countries. Financial statements were not prepared for the benefit of investors and creditors to be used in making investment and lending decisions. Instead, financial statements were prepared to provide the government with information to determine whether the central economic plan was being fulfilled. Financial statements prepared for central planning purposes have limited value in making investment decisions.

## Lack of High-Quality Accounting Information

A fourth problem associated with accounting diversity is the lack of high-quality accounting standards in some parts of the world. There is general agreement that the failure of many banks in the 1997 East Asian financial crisis was due to three factors: a highly leveraged corporate sector, the private sector's reliance on foreign currency debt, and a lack of accounting transparency. 13 To be sure, inadequate disclosure did not create the East Asian meltdown, but it did contribute to the depth and breadth of the crisis. As Rahman explains: "It is a known fact that the very threat of disclosure influences behavior and improves management, particularly risk management. It seems that the lack of appropriate disclosure requirements indirectly contributed to the deficient internal controls and imprudent risk management practices of the corporations and banks in the crisis-hit countries." 14 International investors and creditors were unable to adequately assess risk because financial statements did not reflect the extent of risk exposure due to the following disclosure deficiencies:

- The actual magnitude of debt was hidden by undisclosed related-party transactions and off-balance-sheet financing.
- High levels of exposure to foreign exchange risk were not evident.
- Information on the extent to which investments and loans were made in highly speculative assets (such as real estate) was not available.

- Contingent liabilities for guaranteeing loans, often foreign currency loans, were not reported.
  - Appropriate disclosures regarding loan loss provisions were not made.
- Because of the problems associated with worldwide accounting diversity, attempts to reduce the accounting differences across countries have been ongoing for over three decades. This process is known as *harmonization*. The ultimate goal of harmonization is to have one set of international accounting standards that are followed by all companies around the world.

There is one report which support to the Diversity of Accounting Standards i.e. APEC Report.

The Asia Pacific Economic Corporation Forum (APEC) has released its 2010 economic policy report (prepared by its economic committee) after it was endorsed by foreign and trade ministers at APEC's annual meeting at Yokohoma, Japan.

APEC is an inter governmental organisation with 21 member economies in the Asia-Pacific region ,including Australia, Canada, The people republic's of China, Japan and United States.

The economic policy report discuss various corporate governance matters, including the international harmonisation of accounting standards. In this regard , whilst acknowledging the benefits of IFRS, the report consider that the possibility of maintaining "diversity" in accounting standards, or

permitting choice. This stance is quite different to the direction of the G20, which more strongly favours strong convergence of accounting standards

An extract from the report. :

IAS Harmonization :

Harmonization with international accounting standards is an issue that gains and losses momentum with same regularity but is relevant to the corporate governance. IFRS are not universally accepted in APEC., debate continues about their merits versus other accounting standards. In particular there is corporate governance concern that some accounting standards may be better at encouraging long-term ,stable growth than at facing at on one accounting periods earnings.

However, there are also professional significant benefits to harmonizing accounting standards . universal accounting standards backed by universal professional Domestic Listed Companies

performance standards would allow easy comparison among companies, enabling more efficient capital allocation and global corporate performance, as long as the standardisation or smooth chosen incentivizes long term performance over earnings manipulation or smoothing.

Such standardization increases pressure on companies by forcing them to compete for capital with all other competitors for capital in the world. However if the standard chosen allows fraud to go undetected for some period , the world might suffer a global simultaneous accounting scandal crisis. given the event of past decade such a scenario should be considered . thus , it may be important to maintain diversity in accounting standard s, or even to allow companies to choose which standards to use along with choosing which economy and stock exchange in which to compete for stock exchange.

Example-3  
 Relationship between Several Factors Influencing Accounting Diversity

Country	Legal System	number	per million population	Tax Conformity
Italy	Code	296	5.1	Yes
Germany	Code	783	9.5	Yes
Japan	Code	2,335	18.4	Yes
U.K	Common	2,792	45.6	No
Australia	Common	1,966	91.4	No
Canada	Common	3,700	109.6	No

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## Conclusion

This paper provides direct evidence that reasons and problems faced by all over world through Diversity in Accounting Standards. First I show that , Evidence of diversity in accounting standards with three real examples. Second I show that reasons for diversity. And also third one is problems from diversity. In worldwide every country is facing the problem of diversity. So that, there is no genuine result in providing final accounts. For this reasons we take necessary precautions to reduce diversity in accounting standards in worldwide.

Diversity accounting standards are better than uniform accounting standards, when the cost of investment and variation between firms is large. But worse, when firms productivity and variation between investors is large.

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