International Accounting and Finance

Master Thesis No 2001:11

Harmonization of Accounting Standards

-Disclosure Policies and Practices of European Commercial Banks-

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ISSN 1403-851X
Printed by: Elanders Novum AB

ABSTRACT

This research has been carried out to review the effectiveness of the European Commission (EC) Directive on regulating financial reporting policies and practices of companies in the EU member countries. This has been achieved through a comparative analysis of financial reporting practices of some key European banks. A sample has been drawn from two banks each in the United Kingdom, Sweden and Germany – countries perceived to be a representative of three different financial reporting cultures within the European Union.

Focusing on measurement and valuation methods, consolidation practice, and how financial information is presented, we found that comparable financial reporting exists among banks in the same country more than among banks in different European countries. Any divergence in reporting practice could be explained by the individual banks reporting needs and culture, which are shaped by many factors including the security market[1] requirements and the institutional environments of different member countries. The influence of individual company needs explains why most German banks use the International Accounting Standards, and the influence of different institutional environments explains why most Swedish banks use national standards. The effort of the European Commission has to some extent increased harmonization but not standardization.

Key words: financial reporting, policies and practices, European banks

[1] Stock markets in which the bank is listed or where the bank seeks listing.

ACKNOWLEDGEMENT

We feel very privileged to have completed this work with the help of some people. Our peers, professors, and administrators of the School of Economics and commercial law, especially those within the Graduate Business School who have assisted us enormously in realizing our goal. We are not able to present an exhaustive list; thus we give thanks to every body.

We owe special thanks to our supervisor, Assistant Professor Håkan Javefor for his inspirational approach to supervising, and for bestowing us with the insight of research methods.

We are also indebted to P. Mattila and M. Åhlqvist for their ‘challenger – role’ during our thesis seminars.

We are also very thankful to our Parents, relatives and friends for their moral and financial support during this period of profound dedication in our lives.

May you all receive abundant blessing from the Almighty God.

December 2001

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Chapter 1

1. INTRODUCTION

1.1 BACKGROUND

This work has been undertaken to elucidate the divergence of European commercial banks' reporting policies and practices. Despite the presence of a Basic theoretical infrastructure for uniform reporting, European banks have different reporting practices. We have been inspired by the European Community "One Market" philosophy, a philosophy which has several of us skeptical about its effective applicability in the banking sector. We regard this sector as special, especially as it is involved in a more exposed environment full of uncertainty. The presence of a more special character (culture) has even increased our state of bewilderment as to whether identical reporting practice would ever exist given the cultural frontier that will never end within the EU one market area. Because it is very complex to link cultural policy with economic policy, we have addressed the process and practice of accounting harmonization with a focus on the European community as a whole, and at the national level of countries within the European domestic market, noting that existing cultural diversity on the one hand and company goals on the other hand could influence reporting standards a great deal.

The focus has been on explaining whether one European banks' reporting policies and practices meet the requirements of standards, in relation to the policy and practice of other banks within the European Community. The standards (Directives) of the EC constitute a benchmark, in view of the fact that it is not just a recommendation but also a law binding all banks in member states. It is from this dimension that we have described cultural differences in both the countries and the industry.

We have adopted the investigator perspective on the effects of intra-continental accounting differences on the one market philosophy and seek to provide knowledge potentially relevant to regulators and accounting standard setters who are concerned with the effects of inter-bank accounting differences on the operation of the European internal markets. We recognize the importance of banks and other financial institutions, in terms of their pivotal role in financial markets and in the overall monetary and economic system of the internal market (The Commission of the European Communities, June 2000, Brussels).

1.2 CONCEPTUAL FRAMEWORK

Accounting standards are solid principles for financial accounting and reporting developed through a structured standard setting process and issued by a recognized standard setting body (an Accounting Standards Board). Accounting standards spell out how transactions and other events are to be recognized, measured, presented and disclosed in financial statements. The purpose of such standards is to meet the needs of users of financial statements by providing the information considered necessary to make informed decisions (Canadian Institute of Chartered Accountants).

We difine disclosure as the value added statements or additional information given to cover strategic business areas, which are less covered in the accounts. On the other hand, harmonization reduces the differences in accounting practices across countries ultimately resulting from a set of international norms to be followed worldwide. (Doupnik, et al, 1993)

Banks and similar financial institution are business units whose spectrum of user groups is extensive. Changes in the information provided in annual reports is even more strategic as they are exposed to many business risks resulting from a high volatility of their business environment. The micro and macro economic variables such as interest rates, exchange rates and inflation or price changes are strategic reporting areas. By transacting in exchange-traded financial instruments (such as futures and options, swaps, forwards, and other customized instruments), market participants are able to transform their risk exposures. In anticipation of movements in interest rates, (currency) exchange rates, indices of stock prices or groups of produce, and the prices of various specific commodities, the risk exposures are even better transformed. For instance, if derivatives are suitably employed will enhance general economic welfare thus, creating risks transformations that are pragmatic and cost-effective. Regrettably, current external reporting requirements for financial assets and liabilities, and for derivatives, are not only deficient but also inconsistent. The reporting requirements often coax firms not to hedge important risk exposures and, occasionally, to hedge accounting in place of economic impacts.

1.3 FORCES AND PRESSURES FOR ACCOUNTING HARMONIZATION

The subject matter "Harmonization of disclosure practices" has been discussed and will continue to be discussed by different scholars, accounting bodies, researchers, governments, and regulatory organizations as long as the needs of all parties with interests in financial statements are not fully met. In order to meet the needs of all, efforts have been applied to setting standards that will be internationally/continentally recognised and applied. The subject has a long history from when it was first handled, and has been an essentially political process with a variety of organizations, both public and private, all of them having varying objectives, scope, and powers of enforcement.

Different country groups practicing different accounting systems have distinctive and unique patterns, depending on the history and culture. If securities markets were to continue to operate in an international perspective, no matter where the parent company is based, then investors and other users would prefer accounting standards to be harmonized for easy understanding and comparability. Also, since most multinational firms are in the process of globalization, and because of the free movement of securities and other forms of investments, the integration of markets has brought about some convergence of accounting practices at the level of consolidated accounts of Multinational Enterprises (MNEs) listed on cross boarder stock exchange markets.

Uniform disclosure, therefore, should establish the possibility for financial information to be interpreted by any stakeholder, prospective stakeholders, government and all other interested parties irregardless of location, to make informed decision. A wide range of organizations and user groups have called for additional and more comparable information. Those who have been in active support of international standard setting are governments and international intergovernmental organizations, trade unions and employees, investors and financial analysts, bankers, lenders, creditors, accountants and auditors, and the general public. The forces range from EC directives in the European community, OECD and UN guides, to the IASC's recommendations. The activity of harmonization of accounting standards is complex and dynamic, considering the differences in countries history and culture.

1.4 PROBLEM STATEMENT

The commission of the European Community has been involved in the harmonization or standardization of accounting and reporting standards as far back as the mid-1960s, in fulfillment of the company law harmonization undertaken following the Treaty of Rome in 1957. The Company Law Harmonization ensures that no country will be at a competitive disadvantage as a result of legal differences between countries in order to enhance European integration.

In contrast to the recommendations of UN and OECD, any agreement that takes the form of a "Directive" has the force of law through out the community's countries as each country has the obligation to incorporate such a "Directive" into its respective national law. A good initiative of this type is not observed, as varying reporting policies and practices exist among MNEs.

In spite the early beginning of the quest for international harmonization, the fourth Directive (Annual accounts, content, valuation, preparation rules) was only approved in 1978. The implementation process of harmonized standards took even longer, with Italy being the last to finally amend its company law in 1991(Radebough and Gray, 1997). The quest and effort for uniform reporting of banks is ongoing. In June 2000, the European Commission had a special session in Brussels recommending banks and similar financial institutions to provide enhanced disclosure of their activities in financial instruments and other similar instruments owing to the banks' significant role in the financial markets and in the overall monetary and economic system.

Although the EC recommendation does not make it obligatory to disclose confidential or proprietary information, the commission identified the need for banks and other financial institutions to provide the public with information that is sufficiently comparable for the smooth functioning of the internal European market (Commission of the European Communities, 2000). As per the Commission's specifications, each bank's disclosure statement should contain a wide range of financial and other information, in relation to the bank itself and its banking group. These laws were obviously made to be followed. They were made because the parties (standard setters) drawing them had some objectives to attain. We wonder whether the laws and recommendations are being implemented. Consequently, a survey on standards implementation degree is imperative.

The hypothesis: "*Standards have brought about uniform reporting within the EU banking sector*" will be verified or falsified in this research.

1.5 OBJECTIVE OF THE STUDY

The major objective of this study is to identify any discrepancy in reporting practices among European Commercial banks, using the EC Directives as a benchmark. Minor objectives include the following:

- To describe the process of accounting harmonization within the European Community.
- To identify the divergence existing between theory and practice on financial reporting.

1.6 SIGNIFICANCE OF THE STUDY

Our readers, especially standard setters, may find the results useful in formulating and adapting strategies for revising existing standards. We also intended to open some problem areas for future research in order to widen the focus of knowledge, as demonstrated in existing literature.

Chapter 2

2. LITERATURE REVIEW

In this part of the work, we have examined the meta-theoretical foundation of authors' works relevant to our topic. In the process, we have summarized the main ideas and theories discussed in contemporary literature within the world of our topic. We have also assessed its evolution by citing earlier writings using both textbooks and journals. Both sources have helped us to improve our knowledge on harmonization and practices, by looking at the insights in the state of current knowledge. We have identified the gaps, contradictions, inconsistencies and relations in existing literature on harmonization and disclosure, which of course has greatly influenced our perception and work. Below is a discussion of the relevant literature.

2.1 REPORTING POLICIES AND PRACTICES VS REGULATIONS

Companies reporting policies and practices are influenced by three major factors: their company culture; laws and regulations; and the international business environment. The company's culture stems from the corporation's objectives, especially its reporting motives. A company that targets customers adopts a reporting spirit that fills its annual reports with customer oriented information. A company that targets investors prepares information to meet investors' needs. The modern corporate annual report has become a major tool for promotion by large listed companies. "Poorly packaged, statute-driven accounts are increasingly being replaced by a professionally designed glossy brochure in which the financial statements seem to play only a supporting role. Photographs, graphs and text are often prominently presented at the front, with the balance sheet, income statement and notes to the accounts being regulated to the back. The annual report has become part of corporate public relations" (Beattie, et al, 1996). The forgoing quotation gives us a clear picture of the annual report of SEB, FöreningsSparbanken, Dresdner, Deuchsche Bank, Barclays and HSBC holdings. The focus is no longer on the figures, but to convince the general public on the achievements and plans of the company. This attitude of concentrated decorative reporting impairs harmonization a great deal. Information disclosure is made available in the report where they are suitable for the interest of the company and not necessarily for those who need this information.

Most multinational enterprises (MNEs) that seek international listing (i.e. to have their securities listed in a foreign stock exchange) adopt a policy that to some extend deviates from national laws. They sometimes prepare two sets of accounts – one using the national and the other in accordance with the international standards.[2] In order to reduce the cost of capital, most firms give information even beyond the recommendations of national laws. However, Verrecchia (1999) argues that the compelling evidence indicates more disclosure results to more liquid markets. The perception that the greatest disclosure leads to lower cost of capital is only true when public disclosure is governed by cost-of-capital considerations, given that the existence of information asymmetries in securities markets may ameliorate the cost of capital during disclosure, thereby providing an economic basis for evaluations of costs and benefits of accounting information. His argument was counteracted by Huddart, et al (1999) who believe that public disclosure requirements tend to increase trading costs that, in turn, affect listing decisions of corporate 'insiders' and allocation of liquidity flow. Trading is usually concentrated on highly disclosed exchanges as exchanges try to outperform each other. Therefore, to maximize trading volume and lower trading costs, corporate 'insiders' give away important information to disguise their trades.

Despite the above argument, it is a popular view that the issue of disclosure practice is very much influenced by the culture and needs of the banks, rather than the legislative requirements. According to a study by Vanalaines (2001), he shows that a considerable difference in risk disclosure exists between major

[2] Standards of the foreign country where the firm seeks listing.

European banks. Despite the existence of EC Directives, the differences are to a greater extent due to cultural differences between geographical areas and especially due to differences in size of banks. According to Vanalaines, Nordic, German and Swiss banks tend to be best at presenting disclosures on risk, although British and Spanish banks are also among the top performers in terms of disclosure. His results show that large banks tend to disclose more information than smaller ones. This research adds to our earlier perception that the size of the business unit is another significant determinant of reporting practice. It is obvious that the size of the firm has a positive correlation with the level of disclosure. The larger the firm the more the information to disclose. Vanalaines further identified a wide gap between the poor performers and the best performers. He rated the top ten European banks (in terms of disclosure) as follows:

1999	2000	2001
SEB	UBS	UBS
SUB	MeritaNordbanken	Credit Suisse
FSB	Barclays	HSBC Holdings
UBS	SEB	BSCH
Barclays	Dresdner Bank	Barclays
MritaNordbanken	Societe General	Nordea
ABN Amro	Alled Irish Banks	HypoVereins Bank
Deutsche Bank	The Royal Bank of Scotland	Dresdner Bank
HypoVereins Bank	Den Danske Bank	San Paolo IMI
Standard Chartered	Bank of Ireland	SEB

FIGURE 1: BEST PERFORMING BANKS IN RISK DISCLOSURE 1999-2001

Source: Trema Management Consulting, 30 Jul. 2001

It is not our goal to rate or classify banks in terms of disclosure practices. However, it is important to note that 4 of our 6 sampled European banks featured in this survey, assuming varying positions in the "top-ten" classification above. What is of interest in this survey is that it gives a clear picture of disclosure differences existing among banks within one internal market (the European Community).[3]

2.1.1 *The Influence Of Culture*

Radebaugh and Gray (1997) discuss the issue of cultural influence on reporting practice in detail. Through a comparative study, they conclude that despite the existence of standards,[4] each country's reporting practice is greatly influenced by its culture and history. They even identify the differences in reporting among countries in the same grouping, and state that banks in the same country have reporting features that are unique. This perception highlights the fact that even in any family, individuals have their unique traits, different from others. Radebaugh and Gray (1997) blame history and culture as the cause of uniqueness in reporting practice. In their study, they made the following five groups of countries with identical practices:

Group	Countries in-group
Anglo-Saxon	United States
	United Kingdom
Nordic	The Netherlands
	Sweden
Germanic	Germany
	Switzerland
Latin	France
	Italy
Asian	Japan

FIGURE 2: GROUP OF COUNTRIES WITH IDENTICAL ACCOUNTING PRACTICES.

Source: Adapted from Radebaugh and Gray (1997)

[3] It is presumed that these banks use the EU Directives as reporting standards.
[4] The EU Directives in our case.

Anglo-Saxon accounting is clearly different from other country groupings with particular emphasis on investor interest and the securities market. Nordic accounting has many features similar to Anglo-Saxon and Germanic accounting, while Germanic and Latin accounting have many features in common, but also differ in areas such as uniform reporting. The Japanese accounting system is unique, though it has been viewed as having some influences from the Anglo-Saxon and Germanic traditions. The authors concluded with a hypothesis that the growing quest for international listing by multinationals would bring about some convergence in accounting practices.

Nobes and Roberts (1999) used an analytical approach to explain the sources of accounting systems. Applying the concept of causality (cause and effect), they perceived that most authors believe legal systems influence accounting systems. According to them, one model of accounting rests on two variables, colonial influence and the equity market. This suggests that the type of accounting is an influence on the regulatory system of accounting, the reason why the Netherlands has Roman Law but practices (approximately) the Anglo-Saxon accounting. Another example why they think the accounting system a country adopts is influenced by the regulatory system is the extensive use of the US rules by many continental European companies. We will add to this collection, as we believe it is also for such a reason that the EC is reducing the pressure mounted by allowing EU multinationals to use IASs to prepare one set of accounts by 2005.

Through its Contact Committee the European Commission (EC) has been fighting for uniform reporting by issuing Directives, especially in the area of consolidation accounting.[5] The effort for complete harmony of consolidation practices within the EC has gone a long way in addressing the issue raised by Radebaugh and Gray (1997). The issue of raising standards will not only ease the free movement of securities within the internal market, but also internationally. The EC started by focusing on the internal market, producing Directives with content relevant for the internal market. This led to high cost for companies producing financial information using two standards – the International Accounting Standards and the National standards influenced by

[5] This accounting area is covered in the 4th and 7th Directives

the Directives. This aspect of high cost will not be discussed here, as it would be addressed later in this work.

The Contact Committee of the EC has quickly identified this as one of the shortcomings of the Directives, hence the recent call in June 2000, resulting in "the EU's Financial Reporting Strategy: The Way Forward." The 'forwardness' of the 'reporting strategy', we suspect, was to integrate the EC Directives into the systems of the International Accounting Standards (IASs) so that EU based multinationals will no longer face the psychological and financial trap of information duplication. It is worth recalling that EU based multinationals had to first prepare financial statements using both the internal laws (Directives) and then re-prepare the same accounts using the IASs for international recognition and international comparability. This exercise was not only very costly, but also misled investors and the general public who received different figures in different environments.

In order to solve this problem, the International Accounting Standards Committee (IASC) and the International Organization of Securities Commission (IOSCO) agreed on a joint working program to produce by 1998 a core set of International Accounting Standards (IAS) to be applied by companies seeking international listing of their securities. European companies that sought international listing outside the EU had to prepare their accounts in IASs. The European Commission had to either waive its Directives or accept the IASs, or on the other hand, the IOSC-IASC agreement had to be successful so that IASs issued by the IASC are comparable with the European accounting Directives, and acceptable worldwide.

Agreement on comparability became a point of contention within the profession and academics of accounting as IASC's publication were said to be pro-Anglo-American. On the 14th of November 1995, the EC adopted a "New Accounting Strategy", aimed at satisfying EU multinationals by letting them prepare their accounts according to the IASs on the condition that IASs conform to the European Accounting Directives. Adjustment had taken place at both ends. The EC now recommends that by 2005, all EC companies listed on a regulated market would be required to prepare their consolidated accounts in accordance with the IASs. This is due to the EC's recognition of the fact that accounts prepared by European transnational companies in accordance with national legislation based on the Accounting Directives do not satisfy the different standards required elsewhere in the world for international capital market purposes.

2.2 HARMONIZATION OF INTERNATIONAL ACCOUNTING STANDARDS

2.2.1 *What Is Accounting Harmonization*

Different authors have defined accounting harmonization in different ways. It is presumably not an easy word to define, as neither the European Commission nor other organs of the commission have explicitly defined the concept of accounting harmonization (Christopher Nobes, 1992). Some have even complicated the whole concept, by attempting to substitute harmonization with standardization, implying making the process the same, rather than making it more compatible. In practice, harmonization of accounting tends to mean the process of increasing the compatibility of accounting practices by setting bounds for the degree of variations (Nobes, 1992). This, in our opinion, is presumed to be the most appropriate definition of the concept.

2.2.2 *Accounting Areas With Differing Accounting Policies*

Though analysts sometimes argue that it is necessary to provide disaggregated information in all financial reporting, some are been of the view that it is necessary to concentrate on such accounting areas where users need such disaggregated information. Companies are exposed to different accounting policies in the preparation of their financial statements. In this section, we try to highlight some accounting areas where different accounting policies used may have an impact on the financial results.

According to the Statement of Accounting Standards (SAS1) published by the institute of chartered accountants of India, the following are accounting areas where differing accounting policies can be applied by different enterprises leading to different results.

- Methods of depreciation, depletion and amortization.
- Treatment of expenditure during construction.
- Conversion or translation of foreign currency.
- Valuation of inventories.
- Treatment of goodwill.
- Valuation of investments
- Treatment of retirement benefits
- Recognition of profits on long-term contracts.
- Valuation of fixed assets
- Treatment of contingent liabilities.

Another significant area that has been left out is the treatment of cash flow. Cash flow statements have been one of the areas of accounting with significant differences in reporting practices. It is becoming recognized as an important and integral part of the consolidated financial statement (Radebaugh and gray-1997). It shows the inflow and outflow of funds from various items. Analysts have argued that the statement merely provides an insight into the financial position stability and the liquidity prospects of multinationals, but other schools have argued that for a risk analyst perspective, it is necessary to know the geographical location of the sources and uses of funds. Standards proposed by certain bodies have shown significant differences and variations in regulatory postures on almost every aspect of cash flow. Wallace, et al (1997) argue that the quest for international harmonization of reporting practices cannot be as easy as looking at a cash flow statement, where you identify different ways of categorizing cash flows, alternative formats of presenting cash flows from operating activities and just many other differences. In addition, several issues Such as: the bad debts provision; valuing marketable securities; and the treatment of long-term contracts, can be considered spicific and given particular treatment.

2.2.3 *Practical Differences In Accounting Development and Annual Accounts -An EC Perspective*

Different EC countries have diverse influential factors in their accounting development process. While in some countries, legal and tax considerations, or traditions may be significant contributors; in others the stock and capital markets are of significant influence. The reasons for this may be diverse, but in some cases are meaningful. For example, in countries where the users of accounting information are significantly large corporations exposed to disclosure pressures from international capital markets, the capital market is of utmost importance to them, thus their disclosure need must be fully satisfied and bearing information for the financial statements. We have chosen banks from different accounting areas with different accounting backgrounds so as to show how such differences in accounting backgrounds may influence information presented in the financial statements. The Banks chosen are: Barclays and HSBC, having the Anglo Saxon accounting background SEB bank and Foreningsparbanken with the Nordic accounting background; and Deustche Bank and Dresdner Bank with the Germanic accounting background; In the United Kingdom, for example, the Company Act of 1985, which consolidated all previous existent Company Acts, includes accounting requirements for all limited liability companies.

In the United Kingdom, the stock exchange market and the accounting profession are also influential in the accounting regulatory process. UK annual reports and accounts consist of consolidated profit and loss accounts, a balance sheet and a cash flow statement. To assess a review of operations on a yearly basis, a director’s report is necessarily always included. In consolidation practices, the purchase method is usually followed though in some cases, and merger accounting or pooling method may be required. With regards to their measurement practices, the UK applies a conservative approach than most Anglo Saxon countries where there is constant revaluations of assets like land and buildings to market values. Inventory cost is also determined using the first-in-first-out method (FIFO) permitted for tax purposes, while the last-in-first-out (LIFO) method is not allowed.

In Sweden, for instance, the development of accounting has been strongly influenced by legal and taxation requirements. There is also a tradition of involving the accounting profession in the standard setting process. (Radebaugh and Gray, 1997). Sample Swedish annual reports and accounts always consists of a consolidated balance sheet, an income statement and a board a directors annual report. The parent company financial statement is also always provided. Valuations are sometimes on the basis of historical cost, although revaluations are sometimes permitted, especially in circumstances where valuations are materially in excess of book values.

Depreciation is mostly on a straight-line basis. Inventory cost is determined using the FIFO method. Research and development expenses are frequently capitalized and amortized over a period of five years, although in practice most companies charge research and development as an expense. The purchase method used in consolidation practices is consistent with the EU 7th Directives. Goodwill is written off immediately against reserves or amortized over its useful life. Foreign currency translation follows the closing rate method with the temporal method used in highly inflationary economies.

In the Germanic group of countries, accounting is greatly influenced by company law and taxation. The accounting profession and the stock market are relatively small and play a less influential role in these countries. The situation has changed in recent years where many German companies have gone to foreign stock markets for listings. The Germans have an attitude of presenting transparent and reliable financial information, while interpreting the EU Directives concept of true and fair view as carrying just that meaning. Tax rules dominate legal decisions on accounting issues and the development of accounting principles. German financial statements consist of a consolidated balance sheet and an income statement together with those of the parent. Regularly included are annual reports from the board of directors. The Information therein is frequently very detailed. The Germans are quite conservative in their measurement practices with historic cost accounting applied and revaluations not permitted. Inventory cost is measured with the average method, although LIFO and FIFO are frequently used especially when they correspond to physical usage. Research and development expenses are written off against reserves. The purchase method is used in business combinations and the pooling method is rarely used. No legal requirements exist for foreign currency translation (Radebaugh and Gray, 1997).

Although Radebaugh and Gray's classification may be a reliable basis for identifying differences in development process and the reasons for such differences, other authors have attempted to make what may be looked upon as a more reliable classification. In attempting to identify differences in annual accounts among EC nations, Nobes (1992) made his classification with respect to accounting harmonization in the European community and significant developmental processes by first examining areas where significant differences exist that have a major influence on accounting development. He identified the following areas: publication and audit; formats of accounts; conservatism in providing accounting information; fairness of published information; valuation bases; consolidation practices and others as being realized from different accounting backgrounds; hence, influencing the accounting development in those countries.

According to Nobes (1992), The history of consolidation practices is different among EC countries. In the United Kingdom, for example, consolidation accounting developed shortly after the First World War when holding companies became prevalent. In the Netherlands, for instance, consolidation was practiced, as early as the 1930s but, in most of continental Europe, consolidation is a recent development dating from when most countries adopted the seventh directive in 1985.

In France, for example, there was no law on consolidation until 1985, while in West Germany, consolidation dates back to 1965 when it was made obligatory for public companies. It has been noted that in countries where there has been no tradition of professional accounting measurement standards, and in cases where there were no law or tax requirements, practice has been varied. Valuation bases are another area with significant differences in accounting development. The use of replacement costs and other current values at the expense of historic cost varies greatly among EC countries. In the Netherlands, some Dutch companies have used replacement cost as far back as the 1950s. In the United Kingdom, for instance, there have been frequent revaluations to market values. These fundamental differences in methods of asset valuation made international comparisons difficult for net assets, shareholders funds and many ratios (Nobes, 1992). Looking at the way accounting information is published, there have also been significant differences. In the Anglo-Saxon and many other English speaking countries, accounts have always been published after they have been liquidated. Looking at the UK back in the 19th century, publication and audit have always been required for all companies except dormant ones. The published annual accounts have been available to the public.

Conservatism has also influenced accounting values in different ways. In Germany, for example, bankers have a long history of trying to satisfy that long-term loans were safe by disclosing only information that protects such values; while in the United Kingdom, reference is usually made to the concept of prudence. As far as the issue of fairness in financial information is concerned, corporate laws in UK, Ireland, and The Netherlands were the only ones in EC countries requiring fairness in audited financial statements. This was incorporated in the 4th Directives as a “true and fair view”. In German financial statements, there is still little preference for fairness. Financial reporting is still an exercise of accurate bookkeeping, which has to satisfy detailed rules and the scrutiny of the tax inspector (Nobes, 1992). Unlike Radebaugh and Gray, Nobes identifies principal differences among EC countries in what he calls a two-group classification. He identified specific features in their background, general accounting features, specific accounting features and examples of EC countries that follow this system. See table figure 3 below.

ANGLO-SAXON	CONTINENTAL
BACKGROUND	
English law	Roman law
Large, old and strong profession	Small young and weak profession.
Large stock exchange	Small stock exchange
GENERAL ACCOUNTING FEATURES	
Fair	Legal
Shareholder orientation	Creditor orientation
Disclosure	Secrecy
Tax rules separate	Tax dominated
Substance over form	Form over substance
Professional standards	Government rules
SPECIFIC ACCOUNTING FEATURES.	
Percentage of completion method	Completed contract method
Depreciation over useful lives	Depreciation by tax rules
No legal reserves	Legal reserves
Finance leases capitalized	No lease capitalization
Funds or cash statements	No funds flow statements.
Earnings per share disclosed	No earnings per share disclosed
No secret reserves	Secret reserves.
No tax induced provision	Tax induced provisions
Preliminary expenses expensed	Preliminary expenses capitalized
SOME EXAMPLES OF COUNTRIES.	
UK	FRANCE
IRELAND	GERMANY
DENMARK	AUSTRIA
THE NETHERLANDS	SWEDEN
	SPAIN
	ITALY
	PORTUGAL
	BELGIUM
	GREECE.

FIGURE 3: GROUPS OF COUNTRIES WITH COMMON ACCOUNTING PRACTICES.

Source: Adapted from Nobes, (1992) "Accounting harmonization in Europe: process, progress and prospects and survey data."

It is important to mention the fact that in choosing of our case study, we have used Radebaugh and Grays's analysis, by sub-classifying countries, cultural groups. They based their differentiation on several values that influenced accounting development and differences. Values looked upon in detail included a country's culture, capital markets and the stock exchange development, the influences of taxation, the accounting profession and others.

2.2.4 *The Role Of Different Pressure Groups On Accounting Harmonization Among EC States*

Several pressure groups have had great influence on the entire process of accounting harmonization, both directly and indirectly. Though the various groups have diverse intentions, it has, however, been assumed that their main intention is to get information that will help them formulate policy towards large corporations, such as the multinational firms. It is important to mention that in identifying the various pressure groups, one sees the benefits the assumed pressure groups will get from accounting harmonization.

The institutional environment has had a meaningful influence on the financial environment. The extent of government involvement has been very high in countries with a tradition of detailed prescriptive legislation. According to Saudagaran and Diga (2000), legislation plays two important roles in shaping the institutional environment. Firstly, laws often specify the main criteria for preparing financial reports, to enhance the true and fair view. Secondly, legislation delegates responsibility to a government agency empowered to devise rules it considers appropriate for achieving the objectives of such legislation. Depending on the regulatory intent, different governmental agencies may take charge of the formulation of specific financial reporting requirements; for instance, company registrars for corporate governance aims; securities regulators for capital market; and taxation authorities for tax objectives. The information governments require of corporations varies and is influenced by, among other things, the extent of government planning and regulation. Governments assume taxation requirements have a significant impact on accounting and, as such, need to get involved in accounting harmonization in order to fulfill such requirements. Revenue authorities, for example, have their work complicated when dealing with companies that have foreign branches or subsidiaries.

2.2.5 *International Quasi-Governmental Bodies*

Not only the European Commission has been actively involved in accounting harmonization; the UN, the OECD and many other international quasi-governmental bodies have taken part in the quest for uniform reporting. The history of these inter-quasi-governmental bodies is so long. The UN history can be traced as far back as 1976 when a group of experts were appointed through the activities of the commission on transnational basis. Following consultations with business and trade unions, the OECD issued a set of "guidelines for multinational enterprises" in 1996. The European union has been involved in the issue of accounting harmonization since the middle of the sixties. The first and second directives were concerned with basic issues such as the publication of accounts, and minimum capital, while the fourth and seventh directives have been drawn to lay down rules on preparation and publication of accounts in detail.

2.2.6 *Investors, Analyst And The Stock Markets*

Investors have access to corporate reports and other public available information and use them to make investments and other decisions. Sample decisions may range from buying, selling or holdind investments. Besides, additional information disclosure (especially information about the future prospects of multinationals) on a worldwide basis. Investors and analysts are concerned with the lack of comparability of much of the information that is currently provided (Radebaugh and Gray, 1992). Individual private investors may be of the opinion that if differences in reporting are so large and ill-defined, and reliability of reports is doubtful, direct investments in foreign shares need to be avoided. Some stock exchanges often go further and employ accountants to explain differences or certify certain ambiguous balances before taking a decision.

2.2.7 *Employees And Trade Unions*

Some trade unions participate at intergovernmental levels; and examples include: the European Trade Union Confederation (ETUC); The World Confederation of Labor (WCL); and many others. Their interest centers on information relating to subsidiary activities and employees satisfaction. Information concerning the terms, conditions, scale, security, and location of employment are of special concern to them (Radebaugh and gray, 1992). However, Christopher Nobes (1992) argues that trade unions and other employees groups connected with multinationals may have a desire to understand and compare financial statements involving companies from several countries.

2.2.8 *Credit Institutions*

International credit institutions will constantly be examining, and by implication comparing, the financial statements from different countries. Bankers and lenders may sometimes require borrowers to submit particular accounting information for appraisal and such information needs to be uniform.

2.2.9 *Accountants, Auditors and the General Public*

Their role becomes very important especially when looking at the technical skills and other skills they have in accounting related issues. It is, however, at the level of the international professional organization that most of the developments are taking place in accounting harmonization. Examples of international professional accounting organizations include: the International Accounting Standards Committee (IASC); International Federation of Accountants (IFAC); the American Institute of Certified Public Accountants (AICPA); and many others. Some exist at national levels. They try to formulate and publish accounting standards that will be observed in the preparation and presentation of financial statements for public use.

The general public involves all other interested parties not listed above. Their interest is generally on information about the financial environment.

2.3 THE ISSUE OF TRANSPARENCY IN ACCOUNTING INFORMATION

It has always been argued by members of the accounting world that efficient disclosure of accounting information in an accurate, timely and reliable way will help influence an accurate assessment of a companies financial performance at a particular point in time. As the internal market commissioner for the European commission Frits Bolkestein (2000) puts it, adequate disclosure serves to improve the transparency of financial information published by banks and other financial institutions.

The market is an important user of financial information and an effective assessment of a company's financial situation can't be done if there is not adequate disclosure. But, the question arises, how can financial information be clear when languages and meanings may differ from one country to another? Translation and other problems may hinder transparency and fairness in accounting information, especially when they are not prepared using a particular reporting standard. Users of accounting and other financial information have always been emphasizing the need for the world to have a common accounting language to facilitate an understanding of the information. Country specific accounting principles are so varied that the aspirations for a globally integrated capital market can be fulfilled only through a uniform financial reporting code (Ghosh, 2001).

Chapter 3

3. METHODOLOGY OF STUDY

We believe that in order to formulate a reliable purpose, we have to carry out a reliable literature review. This gives insight into what harmonization and practice actually are; hence, an understanding of the specific problem area is possible. Case study analysis of European banks will be used to support our analysis on a practical level and, by this, we have used two commercial banks from three European countries that have different cultural backgrounds. This section, therefore, sets up a framework and the approaches to solving our problem.

3.1 RESEARCH STRATEGY

The strategy one uses when doing a study depends on how much knowledge he has about the problem area and how well the problem is structured and formulated. The strategic approach we deem appropriate is the descriptive approach, within which we have made some analysis. We have used the 2000 annual reports of six European banks to describe the divergence in reporting practices existing among the European banks.

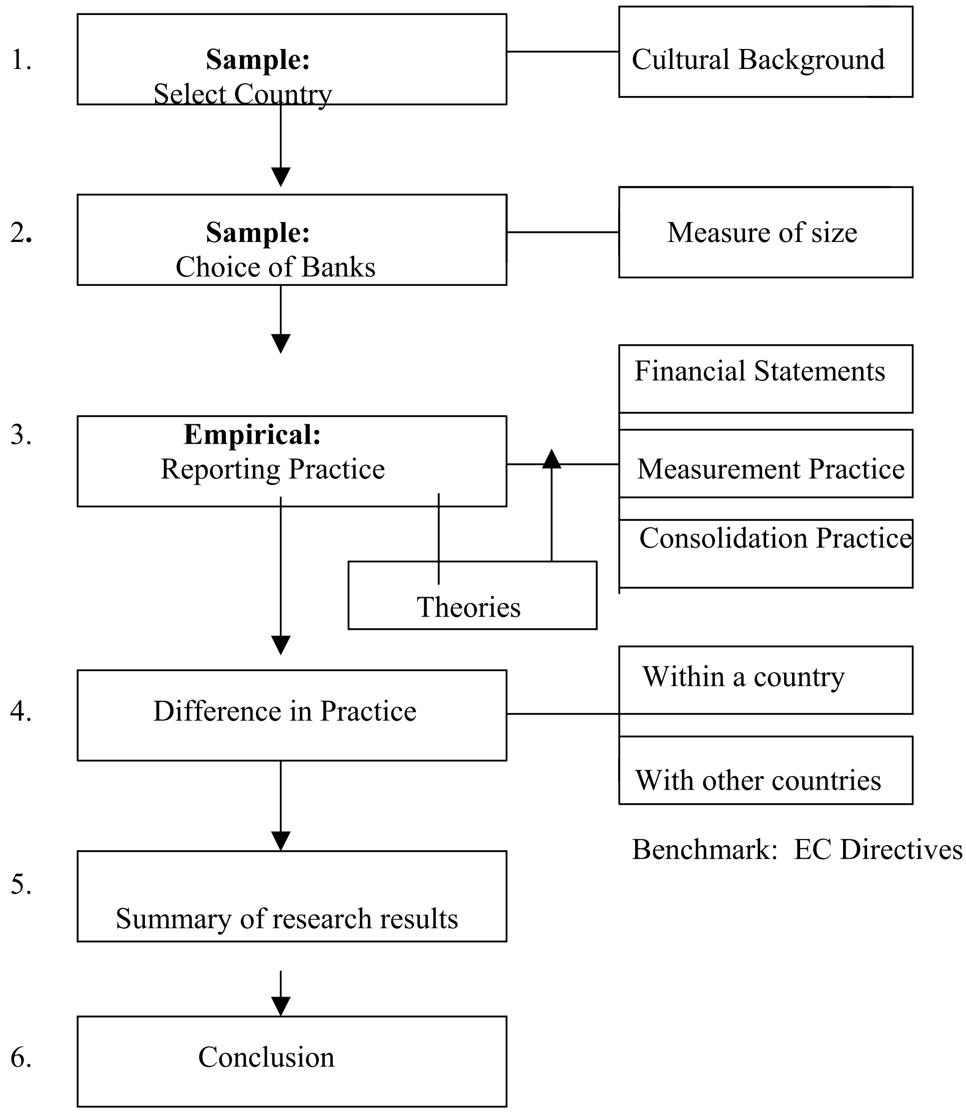

FIGURE 4: PROPOSED RESEARCH DESIGN FOR STUDYING REPORTING PRACTICES.

3.2 CASE STUDY STRATEGY

Since we are doing comparative studies across national boundaries in order to obtain a broad based coverage of the European community, we have classified countries with related culture and history into groups; namely, Anglo-Saxon, Nordic, and Germanic. In the Anglo-Saxon group, we have chosen two banks from the United Kingdom. In the same vein, we have chosen two banks

Germany to represent the Germanic group, and two banks from Sweden to represent the Nordic group.

3.3 CHOICE OF COUNTRIES

While the choice of UK and Germany is obvious, we deem it necessary to give an explanation on our choice of Sweden as representative of the Nordic model. We believe that to assure validity, Sweden constitutes a good representation of the whole of Scandinavian due to its size, which is second to none in the region. We have also considered its industrial nature and its international attachments. Another reason for choosing this country is that this research has been conducted in Sweden (being students of the Graduate Business School of Gothenburg University.)

3.4 CHOICE OF CASE STUDY AND SCOPE OF THE SURVEY

As explained above, we are doing a comparative study across national boundaries, thus a multiple case study approach has been used. To make our conclusion more reliable, we have chosen countries in the European community with different cultural backgrounds. Banks, as our case studies, are from Sweden, Germany, and the United Kingdom. Although our sample is very small for the population within which we are working, our intention is just to illustrate the problems. Our results aim at giving a picture of the situation, and probably promoting further research.

3.5 CHOICE OF BANKS

We resolved to choose banks whose financial statements are available on the net, and which are published in English. These banks should also be large in size in their respective countries. Three factors have been used to measure size; these are: the number of employees, turnover, and income. It is not necessary to discuss size in detail. The banks in the figure below meet these criteria. It is worth mentioning that some banks of comparable size have been left out of the study not because they fail to meet the criteria, but because we intended to reduce the sample size. Consequently, in the population of banks with comparable size, we made a random sample.

FIGURE 5: SCOPE OF THE SURVEY (A PRESENTATION OF SAMPLE)

3.5 DATA AND INFORMATION COLLECTION

In this study, we have used secondary data as the only source of information. We would have used the primary data, especially interview to illustrate further. The existence of time and cost has limited our findings to the use of secondary data. However, this have not very much, affected our results. (See validity) Our secondary data has been collected from annual reports, journals and magazines, as well as textbooks.

3.6 LITERATURE REVIEW

In this part of the thesis, we conduct an extensive search of various articles, literature, databases, and other secondary data, which carries meaningful information on the topic. The prestigious School of Economics and Commercial Law library has been our major source of information, as an extensive search of various databases carrying meaningful information on the topic and topics within its sphere.

3.7 VALIDITY

Validity tells us whether an item measures what it is supposed to measure or describe. Historically, countries with different cultures have often had different approaches to accounting standards preparation. To make our study valid, we have chosen case studies from different cultural backgrounds in order to be able to make an effective comparative analysis.

For an illustration of differences in international accounting practices, secondary data (especially information from annual reports) constitutes a more appropriate data source. Validity can be attained when only the secondary data is analyzed. We are not saying that the primary data would be useless; rather the use of secondary data would add more meaning to the results.

However, it is important to note that interviews give room for normative information, which is not significant in this economic situation. If we had used primary data, instead of getting information on what companies actually do (as published in annual reports), we would have received information on what companies ought to or are supposed to be doing. Interviews could have been indispensable only in the case of explaining what may turn out to be ambiguous or difficult information to understand in the financial statements. Since ambiguity is minimal, we are very convinced that the secondary data used provides us with enough of a basis to accomplish the purpose of this research.

Chapter 4

4 ACCOUNTING POLICIES AND PRACTICES

This section deals with the practical aspect of disclosure by the six banks in the case study. Starting with *FöreningsSparbanken* and the Swedish reporting tradition and ending with Barclays and the UK tradition, we have painted a descriptive picture on the reporting practices in these banks, looking at three main areas; namely: presentation of financial statements; measurement practice of assets and liabilities; and consolidation accounting.

4.1 THE SWEDISH ACCOUNTING

4.1.1 FöreningsSparbanken

Traditionally, FöreningsSparbanken prepares its financial statements in accordance with the Annual Accounts Act for Credit Institution and Securities Companies (AACS), and the regulations and general advice of the Swedish Financial Supervisory Authority (SFSA). However, as of the financial year 2000 the Group applied the recommendations of the Swedish Financial Accounting Standard Council (SFASC) on income taxes (RR 9) and the reporting of associated Companies (RR13).

Presentation of Financial Statement

FöreninsSparbanken's annual report and accounts comprise an overall presentation of the company's present and future surroundings, the board of director's report, the consolidated profit and loss accounts and balance sheet, notes to financial statements and the proposed disposition of profit. Financial statements for both the group and the bank are provided.

Measurement Practice

As usual, during 2000 and 1999, valuation took the form of the historic cost approach. Their building was revalued and added to the balances brought forward at the beginning of the years.

The straight-line method was used to depreciate equipment at 20% of acquisition value. Real estate, with the exception of properties taken over to protect claims, was depreciated at the highest amount allowable for tax purposes. Financial fixed assets, consisting of interest-yielding securities, were valued at their accrued acquisition value (historic cost). Financial current assets, which consist of transferable securities and derivatives in the trading operations, were valued at fair value.

There was no fixed basis for Goodwill amortization. Goodwill was amortized based on an item's economic life. While other Research and Development activities may be capitalized, it is worth noting that the company has a tradition of not capitalizing information technology (IT) systems. The tax on profit for the financial year was calculated by adding deferred tax from previous years to current year tax.

Consolidation Accounting

The consolidated accounts were prepared in accordance with recommendation (RR 1:96) of the Swedish Financial Accounting Standard Council. The consolidated accounts comprise FöreningsSparbanken AB, and those companies in which the Bank directly or indirectly holds more than 50 percent of the voting rights of the shares. These companies were reported in the consolidated accounts using the purchase accounting method. For associated companies (i.e. companies in which the Bank directly or indirectly hold more than 20 percent of the voting right, and where the ownership interest is an element in a long-term affiliation between the Bank and the company) the bank used the equity method. In addition, the bank used the proportional method to consolidate ESkill tuna Rekarne Sparbank AB, which is a associated company. It should be noted that figures for the latter were entered on a separate line on the balance sheet. Amortization of goodwill was deducted from the Groups' share of each associated company's profit. Dormant companies and other companies of insignificant size were not consolidated. Companies taken over to protect claims were also not consolidated since they were of little significance or were expected to be divested within the near future.

Shares in foreign subsidiaries and associated companies that were refinanced in the same currency were valued at their acquisition price in the Parent Company. Subsidiaries and associated companies were translated in accordance with the current method. This means that assets and liabilities were translated to Swedish kroner at the closing day rate, while the profit and loss account is translated at the average rate for the financial year. Translation differences that arose from the use of the current method were entered in the shareholders' equity. This practice is in accordance with recommendation RR 8 of the Swedish Financial Accounting Standards Council.

4.1.2 Skandinaviska Enskilda Banken (S.E.B.)

As with FöreningsSparbanken's Annual Report of 2000, SEB's report was prepared in accordance with the Annual Accounts Act for Credit Institution and Securities Companies, the regulations and general advice of the Swedish Financial Supervisory Authority, and the recommendations of the Swedish Financial Accounting Standard Council.

Presentation of Financial Statements

The annual report of SEB started with a briefing on the bank's present and future economic environment and also contained the board of directors' report; a presentation of the firm's Operational Profit and Loss accounts (which was separated from the Statutory Profit and Loss Accounts) the presentation of the

Balance Sheets; followed by a Cash Flow analysis. It is worth noting that the manner of reporting Operating Profit and Loss Accounts separately from Statutory Profit and Loss Accounts does not occur in the financial statements of FöreningsSparbanken, which only published the Operating profit.

Measurement Practice

Acquisition or historic cost was the method used in valuing financial fixed assets at SEB. The bank used the 'lower of cost or market' method to value current assets, with transferable derivatives instruments and securities in the trading portfolio, as current assets may be valued at market. This is different from FöreningsSparbanken who valued it at fair value.

Interest bearing securities were accounted for using accrual accounting over the life of the instrument. Depreciation of tangible fixed assets was on a straight-line basis, except for equipment leased to clients, which was normally reported at acquisition value but depreciated on an annuity basis. Accrual accounting was used to account for financial cost of the financial liabilities.

Consolidation Accounting

SEB group includes SEB and each of those companies in which the bank directly or indirectly holds more than 50% of the voting power of the shares. Company acquisition was accounted for using the purchase method. In acquisitions, goodwill was amortized over its estimated economic useful life, not exceeding 20 years.

The current rate method was used to translate foreign currency financial statements into Swedish kroner (the reporting currency). Any translation difference was recorded in the consolidated profit and loss account.

It is worth noting that both FöreningsSparbanken and Skandinaviska Enskilda Banken (SEB) have only adapted to the recommendations of Financial

Supervisory Authority during 2000. For comparism, figures for 1999 and 1998 have been recalculated using these recommendations. One of the reasons behind this uniformity may be because of the merger plans of both companies announced at the end of 2000.

4.2 THE GERMANIC ACCOUNTING

4.2.1 Dresdner Bank AB

Dresdner Bank prepared its consolidated financial statements in accordance with the International Accounting Standards (IASs) of the International Accounting Standard Committee (IASC). The statements were prepared under the historic cost convention except for valuation. EU accounting principles were used within the group to facilitate comparability of statements prepared by subsidiaries and those of the parent. The parent company's financial statements were initially prepared in accordance with the Germanic Commercial Code (Handelsgesetzbuch – HGB) and the German Accounting Directives for Banks (Rechkredv), which also complied with the provisions of the German Stock Corporation Act (Aktg).

Presentation of Financial Statements

Like others, the annual report started with a highlight of the group's present and future environments, followed by the Directors' report. The consolidated financial statements began with a presentation of the income statement, balance sheet, statement of changes in shareholders' equity, and, finally, a statement of cash flow. Some notes explaining the application of policies and principles follow the financial statements.

Measurement Practice

It is the group's policy to report trading assets at market value. Investment securities were valued at cost. Property and equipment were recorded at historic purchase or production cost.

Depreciation took the form of straight-line method, with, building being depreciated over a period of between 25 and 50 years. Office furniture and equipment were assigned an estimated life span between 4 and 10 years. Any property and equipment taken under operating lease was not reported in the balance sheet.

Payments made under an operating lease were charged to administrative expenses using the straight-line method over the period of the lease.

Goodwill realized on acquisition was capitalized and amortized on a straight-line basis over a maximum period of 10 years.

Consolidation Accounting

The consolidated financial statements were made up of results from the parent and subsidiaries for which the bank owns either more than 50% of the voting rights or, otherwise, has control over its operation.

The purchase method was used when accounting for acquisitions. Any investments in associated companies and joint ventures were accounted for using the equity method.

All foreign currency financial statements for consolidation are translated using the current rate method (i.e., assets and liabilities were translated at current exchange rate, while the average exchange rate was used to translate the income statement). Any translation difference – gain or loss - was used to adjust the translation reserve and then charged to equity.

4.2.2 Deutsche Bank Ab

Presentation Of Financial Statements

The consolidated financial statement for the parent and the group has been prepared for the year 2000 including: the consolidated income statements, the balance sheets; the statement of changes in equity; the cash flow statement; the notes to the statements; reconciliation statements; and a risk report.

Measurement Practice

As for the principles of consolidation, capital consolidation has been carried out using the book values. Goodwill realized has been amortized using the straight-line basis. Intra group claims and liabilities, expenses and profits as well as interim results is eliminated. All dealings were reported in fair values and changes in fair values are booked to profit and loss accounts. Shares in related companies, which is not consolidated, were shown at cost.

Goodwill from corporate acquisitions are amortized largely over 15 years. If it stems from economically separate business units acquired, it is amortized on a straight-line basis over five years. Property and equipment are also accounted for at the cost of acquisition (hence historic cost). The respective assets are depreciated on a straight-line basis over their estimated useful lives. In case of declines in values, a write down is made. Assets and debts denominated in foreign currencies and spot deals not yet settled are translated at the 'spot' mid rate on balance sheet dates. Forward exchange deals are recorded at a forward rate on balance sheet dates.

Consolidation Practice

The consolidated financial statements were in accordance with the International Accounting Standards (IAS) in force on balance sheets dates. They fulfill both of the conditions of 292 A German commercial code for exemption from preparation of consolidated financial statements. The consolidated financial statements applied all existing international accounting standards in force. Differences between the consolidated financial statements according to IAS and the German reporting were detailed in the reconciliation comments. The consolidated financial statements besides that of Deustche Bank AG (the parent) comprise 117 domestic enterprises, 1061 foreign enterprises, 25 domestic enterprises and 238 foreign enterprises. Two domestic enterprises and 50 foreign enterprises were excluded from the group of consolidated companies.

Capital consolidation was carried out using the book value method. Goodwill is amortized using the straight-line method.

4.3 THE BRITISH ACCOUNTING

4.3.1 HSBC Bank

Presentation Of Financial Statements

HSBC`S annual reports and accounts contain the presentation of both qualitative and quantitative information with regards to the overall operational and other performance evaluations for the business. The company has prepared its consolidated financial statement for all its business operations for the whole of the year 2000. Its consolidated financial statements comprise financial statements of HSBC and its subsidiaries. A case in point is the subsidiary in Argentina (HSBC BANK ARGENTINA) whose financial statements are made by June 30th to comply with local regulations; HSBC used its audited interim financial statements drawn up to 31st December.

To enhance an understanding of both the companies present and future financial environment, the company provides a financial highlight of the operating performance of the firm for a particular period. A five-year comparison also details the activities of the firm. The financial statements have been prepared in accordance with UK GAAP and where deviations exist to the US GAAP, a reconciliatory note is explained in the notes for the financial statements.

Measurement Practice

Several items in the financial statements have been valued using different valuation methods but, generally, the financial statements have been prepared under the historical cost convention. Tangible fixed assets, land and buildings have been valued using the valuation or historic cost (less depreciation), which is calculated to write off the assets over their estimated useful life. Equipment, fixtures and fittings are also stated at cost, less depreciation, and are depreciated using their estimated useful life. Assets and liabilities denominated in foreign currencies are translated into US dollars at the rate of exchange ruling at the year-end (i.e. the closing day rate).

Goodwill capitalized is amortized over its estimated life on a straight-line basis. Preparation requires the use of estimates and assumption for the future, with issues relating to bad and doubtful debts.

Bad debts are written off in parts or in whole when the loss is confirmed. If the collection of interest in bad debts is considered to be doubtful, it is suspended and excluded from interest income in the profit and loss account.

Consolidation Accounting

The banks consolidated financial statement has been prepared in accordance with the special Provisions of part VII Chapter II of the UK Company's Act (1985) relating to banking groups. The consolidated financial statements comply with schedule 9 and the financial statements of HSBC holdings (the parent) comply with schedule 4 of the act. As permitted by section 230 of the act, no profit and loss account of the holdings is presented.

The consolidated financial statements included the financial statements of HSBC holdings and its subsidiaries. Investments in subsidiary undertakings were stated at net asset values, including attributable goodwill. Changes in net assets is accounted for as movements in the revaluation reserves. Interest in joint ventures is stated as the HSBC share of gross assets. Goodwill is included in balance sheets as intangible fixed assets. Capitalized goodwill is amortized over its estimated useful life on a straight-line basis.

4.3.2 Barclays Bank Plc.

Presentation Of Financial Statements

Barclays annual reports and accounts are composed of the traditional consolidated profit and loss account, a statement of total recognized gains and losses for the financial year, consolidated balance sheets, consolidated statement of change in reserves, consolidated cash flow statements, directors reports and notes to the accounts. The parents company's account is also provided.

Measurement Practice

During the year 2000, accounts are prepared under the historical cost convention as modified by the revaluations of certain properties and investments. The bank uses the applicable accounting standards of the Accounting Standards Board, the pronouncements of its Urgent Issues Task Force (UITF), and the Statements of Recommended Accounting Practice (SORP) issued by the British bankers association.

Goodwill arising from the acquisition of subsidiaries and associated undertakings and joint ventures has been capitalized as an intangible asset and amortized against profit over its estimated useful life normally 20 years. Interest in associated undertakings and joint ventures are included in the consolidated balance sheets at the group's share of the book values of the net tangible assets of the undertakings concerned.

An associated undertaking is defined as generally one in which the group owns more than 20 percent of shares, and also exercising significant influence over the entity's operational and financial policies. A joint venture is one where the group holds an interest on a long term basis and which is jointly controlled by the group.

Depreciation of tangible fixed assets is provided on a straight line basis at an annual rate of 2 % for freehold buildings and long leasehold property, leasehold property, over the remaining life of the lease, equipment installed in freehold and leasehold property, 10%, computers and similar equipment, 20-33 % fixtures and fittings and 20% of other equipments.

Consolidation Accounting

The consolidation accounts have been prepared in compliance with sections the Company's Act of 1985. The profit and loss accounts and the balance sheets have been prepared in compliance with section 226 of schedule 4 in to the Company Act of 1985. The consolidated accounts included the accounts of Barclays PLC and its subsidiaries up to the 31st of December. Interest in subsidiaries and joint ventures are included in the consolidated balance sheets at the group's share of book values of the net tangible assets.

Chapter 5

5.1 ANALYSIS

In this part of the work, we have presented the requirements of the EC Directives, on the areas of interest to our research; namely, the presentation of financial statements, measurement practice and consolidation practice. These areas are the focus areas of the thesis, where we hope to test homogeneity in reporting practice. We have, therefore, used the Directive to assess compatibility in reporting practices both within banks in the same country and with banks in different countries.

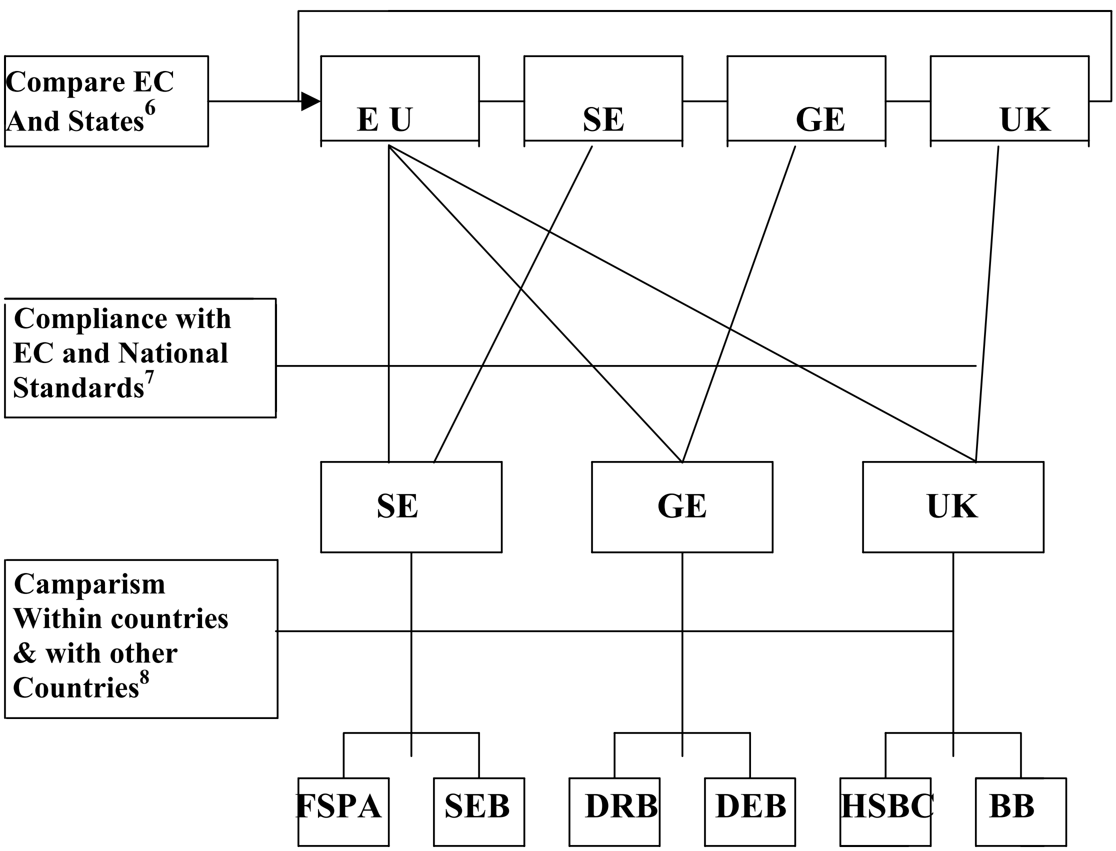

FIGURE 6: PROPOSED COMPARATIVE FRAMEWORK.

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[6] An institutional framework.
[7] Harmonization framework
[8] Application framework.

The figure above is a framework of comparisms to be made in the succeeding section.[9]

Banks Reporting Practices Vs The EC Directives.

Here, we analyze how banks apply the EC Directive, using the Fourth and Seventh Directives, which are financial reporting legislation for companies within the European Union.

Presentation Of Financial Statements

This area is dealt with in Article 2.5 of the fourth directive, which requires a fair application ensured by the concept of prudence. According to article 2.3 of the EC directives, the annual accounts shall give a true and fair view of the assets, liabilities, financial position and the profit and loss of the company. Where application of the provision in the directive is not sufficient to give a true and fair view, Article 2.4 requires that additional information must be given.

The fourth directives requires European companies to separate their assets into "current assets" and "fixed assets", but also does not disagree with the use of IAS, which states that companies can present their assets in order of liquidity.[10]

Assets of some banks are separated into current and fixed assets, and in order of liquidity. This is the case with HSBC Holdings, where assets are separated into fixed and current assets, and also listed in order of liquidity. Barclays does not distinguish between current and fixed assets, rather they present them in order of liquidity. Although the balance sheets of SEB does not separate the assets into current and fixed assets, they are presented in order of liquidity as

[9] EU has been used for European Union, SE; for Sweden, GE; for Germany, UK for the United Kingdom, FSPA for FöreninsSparbanken, SEB; for Scandinaviska Eskilda Banken, DRB; for Dresdner Bank, DB; for Deutsche Bank, and BB; for Barclays Bank. These abbreviations may not be the official ones in some cases They have been used inorder to make them fit into the diagram.

[10] See last sentence of paragraph 53 of the IAS.

recommended by the directive, and in accordance with paragraph 53 of the IAS.

Dresdner does not separate assets into current and fixed assets, but presents them in order of liquidity. Deustche bank does not differentiate its assets into current and fixed assets but are presented in order of liquidity. Föreningsparbanken has not separated its assets into current and fixed assets, but has presents them in order of liquidity starting with cash and ending with prepayments and accrued income.

According to the directive, financial statements should be composed of profit and loss accounts, balance sheets and notes to the accounts. The statement of the changes in equity is not a requirement, but also does not go against the directive because the contact committee recognizes the fact that such a statement attaches more meaning to financial statements. Also, although the directive does not expressly mention the inclusion of a cash flow statement as an item in the financial statement, the directive does not exclude their presentation.

HSBC holdings presents the consolidated profit and loss accounts, balance sheets, statements of total consolidated recognized gains and losses, consolidated cash flow statement and notes to the accounts. The profit and loss account and the balance sheet of Barclays PLC are being prepared in compliance with section 226 and schedule 4 of the Company's Act. The consolidated accounts of Barclays include the consolidated profit and loss accounts, statements of total recognized gains and losses, consolidated balance sheets, consolidated statements of changes in reserves, consolidated cash flow statement, the parent company accounts and the notes to the accounts.

SEB has prepared the following in their consolidated financial statements: the profit and loss accounts, the balance sheets, the cash flow statements and the notes to the accounts. Föreningsparbanken, on the other hand, discloses on their financial statements the profit and loss accounts, the balance sheets, statements of cash flows, notes to the accounts, and proposed profit disposition.

Article 43.1(9) of the fourth directive requires European companies to disclose " the average number of persons employed during the financial year, broken down by categories." SE discloses the average number of employees according to categories. In the annual reports this information has is broken down between the parent and the group and separated and broken down among nations, and between men and women. Further details are given with regards to salaries and remuneration to employees, general administrative and other cost to staffs, loans to employees, pension staffs, and much other information concerning the employees.

Barclays discloses the average number of employees employed during the year by the group. Further explanation is given of the total administrative expenses accrued to them per category. Pension plans; profit sharing facilities and other staff costs have all been explained in the company's annual reports. All further administrative expenses have all been included.

HSBC outlines the average number of person's employed during the financial year and makes a comparison with the previous years. The specific categorization specified here is on the financial sector as a whole, no matter whether it is from either the commercial banking or the investment banking sectors. The bank further gives information on cost accrued to them for example wages, salaries, social security cost, pension and other cost. Benefits accrued to employees upon retirement is also specified.

Deutsche bank discloses the average number of employees employed during the year and further divides it into gender. Also, specification is made as to the number who work part time and full time, and also the number that work abroad. Further explanation is given about their provisions for pension obligations and staff cost.

Föreningsparbanken discloses the average number of employees it employs per year, and specifies according to gender and age categoies. Their academic levels and positions are also specified in their annual reports.

MEASUREMENT PRACTICES

In dealing with depreciation, the fourth directive states that the purchase price or production cost should be the basis for depreciation. As stated above, Article 35.1(c) (bb) of the directive requires fixed assets to be valued at a lower figure on the balance sheet dates, if it is expected that the reduction in their values is permanent.

Article 35.1 (b) is a requirement that fixed assets with a finite life are depreciated over that life. SEB reports its fixed assets using the purchase or acquisition cost and depreciates them according to straight-line basis. Equipment's leased to clients is reported at acquisition value and is depreciated on an annuity basis. As with SEB, the other banks report fixed assets using historic cost, and depreciate them on a straight-line basis. The only exception is for leased equipments, where only Föreningsparbanken follows the SEB policy of using the annuity method, instead of the straight line method as used by the other banks.

Article 37.1 of the fourth directive addresses the treatment of research and development costs. Each member country has the power to decide on this issue. However, it is possible to capitalize both the research and development costs, against the provision of International Accounting Standards, which makes it a must for development costs to be capitalized and rejects the capitalization of research costs.

CONSOLIDATION ACCOUNTING

Accounting for consolidation is addressed in the seventh directive. The directive requires consolidated accounts to be prepared in situations where an entity holds the majority of the voting rights in another enterprise.[11] In this case, the parent company has the right to appoint the majority of the members of the administrative, management or supervisory body of the subsidiary. The main idea is to make sure a true and fair picture of the consolidated entity is presented. Thus, any undertaking whose inclusion would impair the true and fair view of the financial position of the group should be excluded from the consolidated account.

In Sweden, SEB prepares its consolidated accounts with companies where they own 50 % of the voting rights of the company. The bank does not consolidate companies it has taken over with loan foreclosures, provided they are engaging in deviating activities or are planned to be sold in the short term. Föreningsparbanken, on the other hand, consolidates only those companies in which the bank directly or indirectly owns more than 50 % the voting rights of the shares. The consolidated accounts also include associated companies; that is those which the bank directly or indirectly owns more than 20% of the voting rights of the shares. Companies in which the bank owns more than 50 percent are consolidated according to the purchase method while those where the bank owns more that 20 % that is associated companies are consolidated using the equity method.

In Germany, Dresdner Bank consolidates subsidiaries in which the bank directly or indirectly has more than 50 % of the voting rights or otherwise has control over its operations. Such subsidiaries are consolidated from the day on which the group has control over its operations. On the other hand, Deustche Bank consolidates companies according to the number of shareholdings in them. Some were not consolidated as the idea of voting rights is restricted or the shares are held for reasons of subsequent disposal. This is in accordance with IAS 27. consolidation has been carried out by Deustche Bank using the book value.

In the United Kingdom, The consolidated accounts of Barclays Bank include the accounts of Barclays PLC and its subsidiary undertakings as of the 31st of

[11] The voting rights does not necessarily mean majority of share capital. A majority in this case is taken to mean a simple majority,

December. The companies included are those in which the group exerts significant influence over the entities operating and financial policies. For HSBC, the consolidated financial statements include the financial statements of HSBC holdings and its subsidiary undertakings. The consolidated financial statements include the attributable share of the results and reserves of joint ventures and associates.

5.2 SUMMARY OF FINDINGS

With regards to the measurement practices, all banks use the historic cost as a basis for valuation of fixed assets. Tangible fixed assets are also depreciated on a straight-line basis in all the banks, although the number of years may differ among different banks. Most of the banks used the fair values to value financial current assets, except Foreningsparbanken and Dresdner Bank who used the 'lower of cost and market value'.

In all the banks, transferable derivatives were either valued at fair or market values. Goodwill was frequently amortized with variations based mostly on the number of years in which they were amortized. Frequently, the time frame used is between 10 to 20 years, as seen in the table.[11] However, Föreningsparbanken specified no basis for reporting goodwill.

Research and development costs have not been addressed in most banks. However, FöreninsSparbanken records research and development costs when the amount is reasonable, while Dutsche Bank capitalizes research and development costs only on information technology. [12]

Looking at the all the banks consolidation policies, full consolidation is mostly carried out where the parent owns more than 50 % or where the bank has more shareholdings and exercises significant influence on the policies of the subsidiary or associate in question. Acquisition was mostly through the purchase method of accounting. Translation of foreign currency financial

[11] See 'Summary of Findings' table below.
[12] The Bank has a principle of recording research and development costs if the amount is reasonable (material)

statement is mostly conducted using the current rate method. The only exception is the Deustche Bank, which uses the spot-mid-rate. Translation differences are either carried forward to equity, or to the profit and loss accounts, or to the reserves, with each having different effects on the balance sheets results. Shares in associated companies are treated using the equity method in all cases.

There are significant differences with regards to the accounting policies used by the different banks. The two German banks use the International Accounting Standards (IAS) published by the International Accounting Standards Committee (IASC).

The two Swedish banks use the regulations and general advice of the Swedish Financial Supervisory Authority, and the recommendations of the Swedish Financial Accounting Standard Council.

Both British banks use the Company Act and the UK GAAP, and also the applicable accounting standards of the accounting standards board.

Comparism Of Bank's Financial Statement

Banks	FöreninsSp.	SEB	Deutsche	Dresdner	Barclays	HSBC Holdings
Measurement Practice Items:						
Fixed assets	Historic cost	Historic cost	Historic cost	Historic cost	Historic cost	Historic cost
Financial curr. Assets	Lower-of-cost Or market	Fair value	Fair value	Market value	Fair value	Fair value
Transferable Derivatives	Fair value	Market value	NA[13]	Market value	Fair value	Market value
Interest yield security.	Accrual	Accrual	NA	Nominal Value	present. Value	NA
Depreciation:						
Tangible fixed assets	Straight-line	Straight-line	Straight line	Straight-line	Straight line	Straight line
Leased equipment	Annuity	Annuity	Straight line	Straight-line	Straight line	Straight line
Goodwill amortization	No basis	20yrs.	15yrs.	10 yrs.	20 yrs.	15 yrs.
R&D	Capitalized Except IT	NA	Capitalized IT	NA	NA	NA
Consolidation Practice Items:						
Full Consolidation	>50% rights	>50% rights	50% rights	>50% rights	50% rights	50% rights
Acquisition	Purchase Method	Purchase Method	Purchase Method	Purchase Method	Purchase Method	Purchase Method
Translation	Current rate Method	Current rate Method	Spot mid Rate[14]	Current rate Method	Current Method	Current rate Method
Associated company[15]	Equity Method	Equity Method	Equity Method	Equity Method	Equity Method	Equity Method
Translation difference	To equity	To equity	quity/P&L	To equity	Reserves / P&L	Reserves and P&L
Accounting Principle	AACS/SFSA SFASC	AACS/SFSA SFASC	IAS	IAS	SSAP/SORP UITF	FRS/UK GAAP

FIGURE 7: SUMMARY OF FINDINGS.

[13] NA is used to mean 'Not Available' i.e. the annual report does not make specific disclosure in the area.
[14] Spot Mid-rates on the respective balance sheet date (reporting date method).
[15] Percentage of holdings in Associated Company varies with countries and banks.

Chapter 6

6.1 CONCLUSION

It is important to note the compatibility of theory with our findings. European countries have been grouped in to cultural groups (Nordic, Germanic, and Anglo-Saxon) by Radebaugh and Gray (1997) of based on a similar reporting tradition. The findings show that it is no longer the issue of cultural groupings. Banks reporting practice is now very much influenced by the regulations of the stock markets where they seek listing or where they are listed. This assertion matches with Nobes and Robert's (1998) findings that although the Netherlands practices Roman law, its reporting culture is similar to the UK. It is in this light that we fit the relevance of our findings that three very significant factors; namely, company culture, laws and regulations, and international business environment affect, very much, the company reporting practice.

The banks are building a strong culture based on their reporting needs. Although laws and regulations hinder this cultural building, most banks are very much interested in gaining protection against the high competition within the international banking industry of today. Most banks are gradually shifting from geographical groupings to market oriented, and acting in the company's interest. The practice differs from theories to some extent.

Another significant difference between practice and theory is seen in the 'Art' of reporting. Although two banks may use the same accounting standards[16], many differences arise from the interpretation and application of these standards. Also, we have discovered that compatibility is not achievable when the standards give room for too many optional principles.

It is difficult to draw a line on whether the annual accounts provided by a particular bank is the best. This is because a satisfactory information to be

[16] As in SEB and FöreninsSparbanken, Deutsche and Dresdner, HSBC and Barclays.

obtained from any financial statements depends greatly on the needs of the user of such statements. Any conclusion on this aspect is therefore subjective. Considering that quality it self means fitness for purpose, the user who does not find specific information of interest on the annual report considers such a report to be of low quality. There are too many variables to draw a line on this issue.

6.2 CONCLUDING NOTE

As a concluding note, the statement that *"Standards have brought about uniform reporting within the EU banking sector"* is untrue. However, standards have helped to increase harmonization and reduce divergence-reporting policies. Banks within one country and within one-security markets have proven to have more comparable reporting policies and practices.

6.3 LOOKING TO THE FUTURE

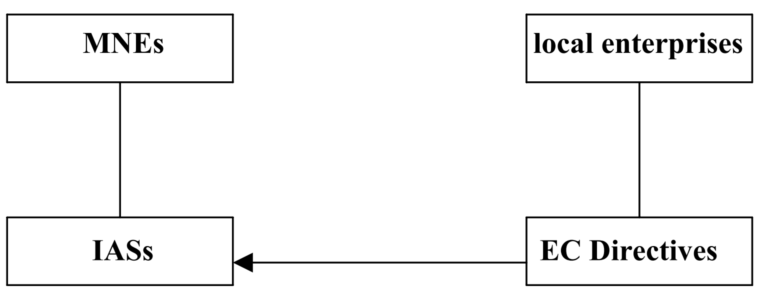

FIGURE 8: ACCOUNTING STANDARDS OF USE BY LOCAL AND MNEs BY 2010

The figure above illustrates that by 2010 the accounting Directive of the European Commission will be redirected to regulating reporting practices of Banks operating within the EU territory. This is because the standards will be inappropriate to be used by global Banks as most of them will be using the International Accounting Standards (IASs) of the International Accounting Standards Committee. The use of IASs has already been expressed in our case by the German banks. Another probability is for the EC to completely duplicate the IASs into the EC Directive. (See projectile in above diagram). An activity like this will not be helpful in that it will only increase the amount of paper work and papers available; yet, another waste of the limited resources. Consequently, it is most likely that the International Accounting Standards will be used by all global Banks.

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