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ACCOUNTING STANDARDS REGARDING PRESENTATION OF FINANCIAL STATEMENTS AND TURKISH FINANCIAL REPORTING SYSTEM

(YÜKSEK LİSANS TEZİ)

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ÖZET

Uluslararası mal ve sermaye hareketlerinin giderek yoğunlaştığı ve iç pazarların yanında dış pazarlardan finansman kaynağı elde etmenin çok çeşitlendiği günümüz koşullarında, firmaların mali yapılarını gösteren finansal tablolar can alıcı öneme sahip olmuşlardır. Her ülkenin kendine özgü standartlar belirlemesi ve finansal tablolarında bu standartları kullanması, ülkelerarası finansal kullanıcılara eksik veya çok detaylı bilgi sunulmasına neden olmaktadır. Uluslararası faaliyet göstermeyen şirketler için bu önemli bir eksiklik gibi görünmese de , uluslararası firmalar için tek bir finansal raporlama bu sorunu ortadan kaldıracaktır. Böyle bir standart raporlama olmadığı taktirde uluslararası faaliyet gösteren firmalar, hem kendi ülkelerinde benimsenen standartlara hem de uluslararası standartlara göre ayrı ayrı çok sayıda finansal tablo hazırlamak zorunda kalacaklardır.

Bu tezin amacı, belli başlı standartlardan A.B.D. , İngiltere, Avrupa Topluluğu ve Türkiye 'ye ait standartları tanıtmak,karşılaştırmak ve ortak bir standarda ulaşma gereğini vurgulamaktır.

Tez başlıca dört bölümden oluşmaktadır. Birinci bölümde öncelikle standarda duyula ihtiyaç ve standart yapma açıklanmış, yukarıda belirtilen ülkeler itibariyle genel kabul görmüş muhasebe ilkeleri tanıtılmıştır. Ülkeler itibariyle ilkelerin ve standartların farklı belirlenme nedenleri, belli başlı uluslar arası finansal raporlama farklılıkları incelenmiştir. Ülkelerde belirlenen genel kabul görmüş muhasebe ilkelerinin ve finansal raporlama farklılıklarının uluslar arası harmanizasyona gidilmesi doğrultusundaki çalışmalar, amaçları, genel çerçeveleri ve ulaştıkları aşama incelenmiştir.

İkinci bölümde yukarıda belirlenen ülkelerdeki finansal raporlama yükümlülükleri, ülkeler bazında ayrı ayrı ele alınarak tanıtılmıştır. Hangi ülke standardına göre hazırlandığını bilindiği taktirde, yükümlülüklerin analizlerine katılmasını olanaklı kılacak bir çerçeve oluşturulmaya çalışılmıştır.

Türkiye Muhasebe standardını diğer ülke standartları ile karşılaştırdığımızda çeşitli amaçlara ve standartlara göre aynı tablodan birden çok farklı değerler içeren tablolar hazırlanmak zorunda kalınmaktadır. Ayrıca, hazırlanan finansal tablo sayısı bakımından da ülkemiz en çok tablo düzenleme ihtiyacı yaratan bir sisteme sahiptir. Uygulama açısından bu kadar çok sayıda tablo hazırlanması zorluğunu göz önünde bulunduran otoriteler sistemde varolmasına rağmen bazı tabloların düzenlenmesini istememektedirler.

Türkiye'de faaliyet gösteren firmalar düzenleme amaçlarına göre standartları farklılaşan birden çok finansal tablo düzenlemek zorunda kalmaktadırlar. Tüm firmalar tek düzen muhasebe sistemine göre mali tablolarını düzenlemek zorundadırlar. Bu tablolar üzerinde vergi yasalarına göre yapmak zorunda oldukları farklılıklarla, vergi amaçlı bir finansal tablo düzenlemektedirler. Halka açık firmalar ise Sermaye Piyasası Kuruluna vermek ve yayınlamasını sağlamak için Sermaye Piyasası Muhasebe standartlarına göre ayrıca finansal tablo hazırlamak zorundadırlar. Bunlara ilave olarak uluslararası iktisadi ve mali piyasalarda faaliyet gösteren firmalar bu ilişkilerini yürütmek için uluslararası muhasebe standartlarına göre finansal tablo hazırlamaktadırlar. Ülkemizde birden çok standarda göre finansal tablo hazırlama zorunluluğunu ortadan kaldırmak amacıyla çalışmalarını sürdüren TMUDESK'in çoğunlukla uluslararası standartların çevirisi niteliğinde olan Türk standartlarını oluşturma çabası uygulama açısından günümüze kadar başarıya ulaşamamıştır. SPK'nın 18.2.1999 tarihinde yayınlanan 4487 sayılı yasasının ek yirmiyedinci maddesine göre oluşturulan Başbakanlığa bağlı kurul, yaptırım gücüne sahip olduğu için engellerden ilkini kolayca aşabilecek görünüm arz etmektedir. Ülkemiz koşullarına uygun tek bir standart belirleme konusundaki ikinci engeli aşabildiği takdirde uluslararası standartlara da uyumlu bir finansal raporlamaya ulaşılacaktır.

ABSTRACT

Today, as international movements of goods and capital become more and more intensive and financial sources from international markets besides domestic markets vary a lot, financial statements which show the financial structures of firms have begun to have great importance.

When each country prepare a unique standard and use these standards in its financial statements, international statement users have incomplete or much detailed information. For domestic firms, this may not be an important drawback. But for international firms, a unique financial reporting will solve this problem. Without such a standard reporting, international firms will have to prepare many financial statements which suit both the country's unique standards and international standards.

The purpose of this thesis is, to describe and compare the standards which prevailing in United States, United Kingdom, European Union and Turkey, and which are of the major standards and to emphasize the necessity of a common standard.

This thesis consists of four main parts. In the first part, firstly necessity and process of setting accounting standards are explained and accounting principles that are generally accepted by the countries mentioned above are described. The reasons of different principles and standards in different countries, and main differences in international financial reportings are analyzed. The study that is being done to make an international harmonization of accounting principles that are generally accepted by countries and different financial reportings are explained; also the purposes, general frames of these studies and the stage they have arrived is mentioned.

In the second part, the financial reporting requirements in the countries mentioned above are described one by one. A general frame is tried to be formed to make it possible to have the requirements included in the analysis in case that the country of the standard is known.

In the third part, financial reporting requirements of each country is compared one by one with the Turkish Accounting Standard only in regard with the present obligations. A frame of analysis for taking advantage of other countries' applications to evaluate and come over the problems which may take place when a requirement is applied or is not applied in international arena is tried to be formed. Also a healthy evaluation of the applications in our country is aimed.

When we compare Turkish Accounting Standard with other countries' standards more than one statement with different values from the same format should be formed according to several purposes and standards. Also our country have a system which makes it necessary to form many statements. As authorities take the difficulty of forming so many statements into consideration, they may eliminate some of the statements, although these statements take place in the system.

Firms operating in Turkey have to form more than one statement whose standards differ according to the formation purposes. All firms have to prepare their financial statements according to Turkish Uniform Accounting System. With these differences that they have to make according to the tax legalities on these statements, they form a financial statement with a tax purpose. Firms that open to the public also have to form a statement according to Capital Market Board's Accounting standards, to give it to SPK and have it published. Firms operating in economic and financial markets have to form financial statements according to international accounting standards in order to continue their affairs. TMUDESK has been trying to eliminate the obligation to form financial statements according to more than one standard but it tries to form Turkish standards which are generally translations of international standards have been unsuccessful until today. Because there is a deficiency to evaluate our country's conditions and TMUDESK is not a formal institution. The committee which has been formed according to the additional 27. Paragraph of the law numbered 4487 with the date of 18.2.1999 of SPK, seems to be able to overcome the first obstacle because it has a sanction power. If the second obstacle of forming a unique standard suitable to our country's conditions can also be solved, a financial reporting with international standards will be maintained.

LIST OF ABBREVIATIONS

AAA : American Accounting Association

AICPA: American Institute of Certified Public Accountants

APB : Accounting Principles Board (U.S.)

ASB: Accounting Standards Board (U.K.)

ASC: Accounting Standards Committee

CAP : Committee on Accounting Procedure

CPA : Certified Public Accountant

CMB: Turkish Capital Market Board

EEC: European Economic Community

FAF : Financial Accounting Foundation

FASB : Financial Accounting Standards Board U.S.

FRC: Financial Reporting Council

FRED : Financial Reporting Exposure Draft in U.K.

FRS: Financial Reporting Standards

GAAP : General Accepted Accounting Principles U.S.

IAS : International Accounting Standards

IASC : International Accounting Standards Committee

ICAEW : The Institute of Chartered Accountants in England and Wales

SEC : Securities and Exchange Commission

SEE : State Economic Enterprises

SFAS : Statements of Financial Accounting Standard (U.S.)

SSAP :Statements of Standard Accounting Practice (U.K.)

TMUDESK: Accounting and Auditing Standards Committee of Turkey

TAASC : Accounting and Auditing Standards Committee of Turkey

TMS : Turkish Accounting Standards

TUA : Turkish Uniform Accounting System

TURMOB :Turkish Accountants Chamber Union (TACU)

U.K. : United Kingdom

U.S. : United States

0.PREFACE

In order to make the amount included in the financial statements mean the same value for statement users, necessity of standardization has been born.

Financial statements can be prepared using different values like recorded value, current value and mean value, according to the legal frame that statement preparers are due to and the purpose of preparing statements. To be able to make a healthy evaluation (comment), financial statement preparers need to know which value is used in preparing the statement. They also need to know what kind of asset and liability is observed under the account. There are some standards that several organizations prepare according to their priorities, in order to make the information in the financial statements standard.

The purpose of this thesis is to analyze some of these major standards, the standards that belong to United States, United Kingdom, European Union and Turkey, in relation with the financial reporting requirements which have to be obeyed by the users to give dependable, easy to understand and comparative information.

This thesis consists of four main parts. In the first part, firstly necessity and process of setting accounting standards are explained and accounting principles that are generally accepted by the countries mentioned above are described. The reasons of different principles and standards in different countries, and main differences in international financial reportings are analyzed. The studies that is being done to make an international harmonization of accounting principles that are generally accepted by countries and different financial reportings are explained; also the purposes, general frames of these studies and the stage they have arrived is mentioned.

In the second part, the financial reporting requirements in the countries mentioned above. are described one by one. A general frame is tried to be prepared to make it possible to have the requirements included in the analysis in case that the country of the standard is known.

In the third part, financial reporting requirements of each country is compared one by one with the Turkish Accounting Standard only in regard with the present obligations. A frame of analysis for taking advantage of other countries' applications to evaluate and come over the problems which may take place when a requirement is applied or is not applied in international arena is tried to be formed. Also a healthy evaluation of the applications in our country is aimed.

In the fourth part, the consolidated financial statement dated 31. 12. 1999 and the financial report of the footnotes that is reformed due to standards IAS 1, 12, 19 and 29 of Hürgüç Gazetecilik Ticaret Turizm Organizasyon A.Ş. which operates in our country, takes place in the Appendix. The harmony of the evaluation and presentation in this sample with the Turkish Uniform Accounting System is analyzed.

In different parts, the differences between the reporting standards of the countries which are analyzed in condition of different criterion; and the necessity of forming international In accounting standards as a strict reason of globalization are tried to be expressed.

1.GENERAL ACCEPTED ACCOUNTING PRINCIPLES IN DIFFERENT COUNTRIES & HARMONIZATION EFFORTS

1.1. NECESSITY OF STANDARDS

1.1.1. Need for Accounting Standards

Accounting was created as a tool to aid in measuring economic activity. The evolution of accounting in various countries has inevitably led to different practices and regulations. As the economic systems and trading conditions vary from one country to another, so do the accounting models and methods. Factors influencing these variations include the degree of centralization in the economy, ranging from state control to unfettered free enterprise, the pattern and rate of economic growth, the stability of the local currency, which connotes the inflationary experience of the local economy.

In addition to the economic system differences, disparate legal systems have had a profound effect on the approach to accounting and financial reporting.

Whatever the economic and legal system, in virtually every country in the free world there is some degree of regulations of the accounting profession by either government regulatory bodies or professional societies, or by both. The overall result is a complex agglomeration of laws, rules, and standards.

Basically classification scheme shows that accounting standards are attempting to provide answers to four questions which are asked in the following order as financial statements.

1. What are the recommended methods of asset valuation and income measurement? Valuation and profit measurement.
2. Which principles have been followed in the preparation of financial statements concerned? Description.
3. What items to be presented? Disclosure.
4. How are the items to be presented? Presentation.[1]

[1] Harvey Mike & Keer Fred, **Financial Accounting Theory and Standards**, United Kingdom , Prentice Hall Inc., 1983, p. 183

Prof. Edey divides requirements under standards into four main types:

1. *Type 1 "Presentation"* states that accountants must tell people what they are doing by disclosing the methods and assumptions (accounting policies) they have adopted.
2. *Type 2 "Disclosure"* aims at achieving some uniformity of presentation of accounting statements.
3. *Type 3 "Description"* calls for the disclosure of specific matters in which the user may be called to exercise his or her own judgment.
4. *Type 4 "Valuation and profit measurement"* requires implicit or explicit decisions to be made about approved asset valuation and income determination.[2]

In the more developed countries of the world, there are two distinct types of regulatory environments, which in turn have fostered two different paths of evolution of accounting theory and practice. While there is a vast range of differences even within these groupings, it seems that a key distinction has been between those countries that have had a *common law* custom versus those that have followed a *code(case) law* tradition. [3]

Common law countries tend not to define financial reporting requirements in their national laws and the rules that have developed are largely those of the private sector, having over time been established by practitioners working through their professional bodies, as well as by the works of academicians. In common law countries, the goal of financial reporting is often different than those of national tax policy.[4] The difference between common law countries and code law countries caused by the rules that have developed in the nations. These are the tradition of free enterprise versus centrally planned economies.

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[2] Ahmed R. Belkaovi, **Accounting Theory**, U.S.A., Harcourt Brace & Company, 1993, p. 74

[3] Barry J. Epstein, Abbas Ali Mirza; **Interpretation and Application of International Accounting Standards 1999**, Canada, John Wiley & Sons, Inc., 1999, p.2

[4] **Ibid.**, p.2

1.1.2. Setting Accounting Standards

The standard setting process has proceeded by varying routes in the major nations of the developed world. For example, the United States and the United Kingdom have been influenced by the same traditions of common law, capitalism, highly educated and professional work forces, large and sophisticated companies that raise equity capital in the public markets and a belief in the responsibility of management to report on their stewardship to the owners of the respective business.[5]

The principle of full disclosure is very important in both the United States and the United Kingdom. Financial statements are expected to be transparent, so that the users, generally assumed to be investors and creditors, are able to understand fully the nature of the reporting enterprise's operations and finances. The profession itself largely establishes rules and tax reporting is a distinct and separate matter, which does not drive financial reporting.[6]

Standard setting in the United Kingdom; for most major projects, the first formal stage of the development of a standard will be the publication of a discussion paper. Such documents normally set out the need for a new or revised accounting standard, describe the problems perceived and suggest various ways in which a solution might be developed. A period of time normally three months is given for comments that are taken from the interested public to be sent to the project director. When the comments have been received they are analyzed and the Board considers the issues raised by respondents. The ASB (Accounting Standard Board in United Kingdom) will then publish for further public comment an exposure draft designed as a FRED (financial reporting exposure draft). After then Board reaches its conclusion and issues its final pronouncement in the form of a Financial Reporting Standard (FRS) or other publication, which specifies the date on which it becomes effective.[7]

[5] **Ibid.**, p.4
[6] **Ibid.**, p.4
[7] Intenet Web Sitesi: www.asb.org.uk , "Working Methods"

Standard setting in the United States is also in the private sector, although the public markets regulator, the Securities and Exchange Commission (the SEC) has statutory authority to establish GAAP (General Accepted Accounting Principles) for public countries, Financial Accounting Standards Board (the FASB) has been the primary US accounting standard setter. The responsibility of FASB is setting accounting standards has been divorced from the process of making auditing rules.[8]

General purpose financial reporting in the United States, as in the United Kingdom, is intended to serve the needs of investors, lenders and other interested parties, that can also include regulatory authorities. However there is no pretence that GAAP will measure taxable income and indeed the reason for deferred income tax accounting is that tax reporting will almost differ from financial reporting prepared in conformity with GAAP. [9]

As compared with the United States and the United Kingdom, countries in Europe, have capitalist economic systems that rely less on public equity markets and much more on bank financing. The relationship between the borrowers and lenders are much closer than those that generally exist between companies and their equity investors, as they are typically far fewer lenders than stockholders and lenders. There is greater ability to obtain information informally; that is, key lenders can demand information from their borrowers at will, and are not limited by what disclosures are mandated by accounting standards, or by the frequency with which financial reporting is made to shareholders.[10]

Financial reporting requirements in Europe differ from those in the United States and other countries because of differences in their economies, relevance of local commercial law to the development of reporting standards.[11]

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[8] Epstein & Mirza, **op.cit.**, p.5

[9] **Ibid.**, p.5

[10] **Ibid.**, p.5

[11] Gerald I. White, Ashwinpaul C. Sondhi & Dov Fried, **Analysis and use of Financial Statements**, Second Edition, Canada, John Wiley & Sons,Inc., 1998, p.13

1.1.3. Need for International Accounting Standards

Major changes in business practices following World war II have led to demands for the internationalization of accounting practices.[12]

To support cross-border investment and financing decisions, the world needs a single, uniform, globally applied and enforced set of financial accounting and reporting standards. Here are the six reasons why;

1. Most stock exchanges around the world have foreign listings – in many cases it is a relatively large part of total listings.
2. Some bond markets also have a relatively large percentage of foreign listings.
3. Cross-border securities sales in some major countries exceed the country's gross domestic product.
4. Securities sales by foreign issuers in US markets have grown dramatically in terms of the amount of capital raised and in terms of the number of new foreign issuers.
5. Shares of foreign issuers from fifty-four countries are registered with the US Securities and Exchange Commission.
6. Foreign issuers account for nearly 70% of the market value of the London Stock Exchange listed companies.
7. Foreign direct investment is huge.[13]

The globalization of capital markets has also contributed to the need to address harmonization of financial reporting requirements. As a result of major international economic assistance programs after the war, there has been a significant growth and development of international markets. This vast global capital market needs, but does not yet have, a common accounting "language" for the communication of financial information. Recognition of this need is significant influence and a major force in the development of, and progress toward, internationalized accounting standards. Without this

[12] Epstein & Mirza, **op.cit.**, p.8

[13] Peter Pacter, **" Why Global Standards? Seven reasons why the world needs IASs"**, Accountancy International, July 1998, p.60

"common language" there is some doubt that given diverse national standards, a truly efficient international market will develop, and this may impair the ability of capital-seeking corporations to compete effectively for the capital otherwise available in the world markets.[14]

1.2.UNITED STATES GAAP

Early 1900's; financial reports emphasized solvency and liquidity and were limited to internal use and scrutiny by banks and other lending institutions. From 1900 to 1929, the growth of large corporations, with their absentee ownership, led to increasing investment and speculation in corporate stock. Unfortunately, after a couple of days on which stock prices dropped rapidly, both individual and institutional investors panicked and sold over 16 million shares of stock at huge losses. The stock market crashed in 1929 and contributed to the Great Depression.[15] From that time, improving accountant by certified accountant professions became more important. In 1887 American Association of Public Accounts was established. [16]The American Association of Public Accountants issued a Statement of accounting principles in 1938. In 1939 it charged its Committee on Accounting Procedure (CAP) to issue accounting research bulletins. It is not a successful body. This association renamed as American Institute of Accountants in 1957. It is the organization of certified public accountants. The CAP was disbanded on 1 September 1959 and the Accounting Principles Board (APB) establish to replace it. In 1973 it was disbanded.[17]

Since 1973, the Financial Accounting Standards Board has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards govern the preparation

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[14] Epstein & Mirza, **op.cit.** , p.8-9
[15] Donald E. Kieso & Jerry J. Weygandt , **Intermediate Accounting**, Ninth Edition, Canada, John Wiley & Sons, Inc., 1998, p.7
[16] Şensoy Necdet, " Amerika Birleşik Devletlerinde Muhasebe Mesleği, Meslek Örgütleri ve Muhasebe İlkeleri" MÖDAV bülteni, sayı 8, Ekim 1997, p.30
[17] Harvey & Keer, **op.cit.**, p.182

of financial reports. They are officially recognized as authoritative by the SEC and AICPA. [18]

1887 ---- American Association of Public Accounts was established
1938 ---- Statement of accounting principles issued by American Association of Public Accounts
1939 ---- Committee on accounting Procedure is charged to issue accounting bulletins
1957 ---- American Institute of Accountant replaced AACPA
1959 ---- Committee on accounting Procedure was disbanded
1959 ---- Accounting Principles Board replaced CAP
1966 ---- American Accounting Association was established by US academics
1973 ---- Financial Accounting Standards Board was established

The Financial Accounting Standards Board (FASB) which is independent of the AICPA replaced the APB.

On the academic front at the beginning of the twentieth century the US academics established a body called the American Accounting Association (AAA). Later, membership of this body was widened to include practicing accountants. One objective of the AAA, is to encourage research in accounting. In 1966, AAA's committee published a paper entitled as A Statement of basic Accounting Theory. One of main concept in this paper is that should be used in the preparation of accounting reports. There are: relevance, verifiability, freedom from bias and quantifiability.[19]

Financial Accounting Foundation (FAF) is established for the purpose of education, philanthropy, science and literature according to the concerned laws. This foundation organizes the FASB and GASB. Foundation has the

[18] Internet Web Sitesi: www.aicpa.org, "Facts about FASB"
[19] Harvey Mike & Keer Fred, **op.cit.**, p.181

responsibility for electing members of the committees, their funds and audits.[20]

US GAAP; generally accepted accounting principles are the minimum uniformed standards and guide for financial accounting and reporting. FASB and Government Accounting Standards Board (GASB) have an authority to forming this principles. GAAP has a position as a country's accounting body of current law in United States. [21]

The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information.[22] The mission of the GASB is to establish and improve standards of state and local governmental accounting and financial reporting that will result in useful information for users of financial reports and guide and educate the public, including issuers, auditors and users of those financial reports.[23]

Generally Accepted Accounting Principles are those principles that have 'substantial authoritative support.' The AICPA' s Code of Professional Conduct requires that members prepare financial statements in accordance with generally accepted accounting principles.

A number of organizations are instrumental in the development of financial accounting standards (GAAP) in the United States. Early 1900's; financial reports emphasized solvency and liquidity and were limited to internal use and scrutiny by banks and other lending institutions. From 1900 to 1929, the growth of large corporations, with their absentee ownership, led to increasing investment and speculation in corporate stock. Unfortunately, after a couple of days on which stock prices dropped rapidly, both individual and

[20] Şensoy Necdet, **op.cit.**, p.36
[21] **Ibid..**, p.32

[22] Internet Web Sitesi: www.nan.shh.fi/raw/fasb/facts, "The Mission of the Financial Accounting Standards Board"

[23] Internet Web Sitesi: www.aicpa.org, FASB & GASB

institutional investors panicked and sold over 16 million shares of stock at huge losses. The stock market crashed in 1929 and contributed to the Great Depression.[24]

As a result of these events, the federal government established the security and Exchange Commission (SEC) to help and standardize financial information presented to stockholders. The SEC is a federal agency. Many companies that issue securities to public or are listed on a stock exchange are required to file audited financial statements with the SEC. The SEC has broad powers to prescribe, in whatever detail it desires, the accounting practices and standards to be employed by companies that fall within its jurisdiction.[25]

At the time the SEC was created, no group –public or private- was issuing accounting standards. The SEC encouraged the creation of a private standard-setting body because it believed that the private sector had the resources and talent to develop appropriate accounting standards. As a result, accounting standards have generally developed in the private sector either through the American Institute of Certified Public Accountants (AICPA) or the Financial Accounting Standards Board (FASB).[26]

The SEC has affirmed its support for the FASB by indicating that financial statements confirming to standards set by the FASB will be presumed to have substantial authoritative support. In short, The SEC requires registrants to adhere to GAAP. In addition, it has indicated in its reports to Congress that "it continues to believe that the initiative for establishing and improving accounting standards should remain in the private sector."[27]

[24] Kieso & Weygandt , **op.cit.** , p.7
[25] **Ibid.**, p.7
[26] Internet Web Sitesi: www.aicpa.org. , "About SEC"

[27] Kieso & Weygandt, **op.cit.** , p.7

The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information.

Accounting standards are essential to the efficient functioning of the economy because decisions about the allocation of resources rely heavily on credible, concise and understandable financial information. Financial information about the operations and financial position of individual entities also is used by the public in making various other kinds of decisions.

To accomplish its mission, the FASB acts to:[28]

1. Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency;
2. Keep standards current to reflect changes in methods of doing business and changes in the economic environment;
3. Consider promptly any significant areas of deficiency in financial reporting that might be improved through the standard-setting process;
4. Promote the international comparability of accounting standards concurrent with improving the quality of financial reporting; and
5. Improve the common understanding of nature and purposes of information contained in financial reports.

Over the years, the accounting profession has developed a set of guiding standards, called GAAP due to their widespread use. Some of the basic generally accepted accounting principles are;

- Entity; a separate set of records must be kept for each business enterprise of an owner.
- Going concern; it is assumed that an entity is a going concern, that it will continue in operation indefinitely, unless there is evidence to the contrary.
- Consistency; the same procedure be followed in all future entries so that statements covering different time periods will be comparable.

[28] Internet Web Sitesi: www.nan.shh.fi/raw/fasb/facts , "The Mission of the Accounting Standards Board"

- Conservatism; it aims to avoid favorable exaggeration in accounting reports.
- Periodicity; it holds that items of expense and revenue can be allocated to such time periods so that expenses and revenues can be properly matched for income determination.
- Objective evidence, the amounts used in recording events are based upon objective evidence rather than subjective judgement.
- Materiality; it depends on the size and the nature of the item relative to the size of the business.
- Full disclosure; financial statements should report all significant financial and economic information relating to an entity. If the accounting system does not automatically capture some specific item of significance, it should be included in a footnote to the accounting statements.
- Historical cost; it states that actual incurred cost is the appropriate amount to be used to record the value of a newly acquired asset.
- Stable dollar; it assumes that the dollar is sufficiently free from changes in purchasing power to be used as the basic unit of measure in accounting without adjustment for price-level changes.
- Revenue realization; under the assumptions of accrual accounting, revenue is said to be realized when it is "earned". Revenue is earned in the accounting period in which the sale is construed to have taken place. Two other revenue realization methods are acceptable under specific circumstances: the collection and the percentage of completion method. Under the collection method, the realization of revenue is deferred under the cash is collected. The other alternative is the percentage of completion method. Under this method, is appropriate for large construction projects requiring more than one accounting period to complete. In this method, several periods might go by with no expense or revenue shown. Then in the period that the project was completed, a large amount of expense or revenue would be recorded.

- Matching expense and revenue; it states that expenses incurred in the generation of revenues should be matched against those revenues in the determination of income.[29]

1.3. UNITED KINGDOM GAAP

The number of associations which are organized the accountants, is too much in United Kingdom. Fourteen of them are established. But from these established associations, only six of them are privileged by the Royal Charter. These are;

- The Institute of Chartered Accountants in England and Wales (ICAEW),
- The Institute of Chartered Accounts of Scotland (ICAS),
- The Institute of Chartered Accounts in Ireland (ICAI),
- Chartered Association of certified Accountants (ACCA),
- The Institute of Cost and Management Accountants (ICMA) and
- Chartered Institute of Public Finance and Accountancy (CIPFA).

The Institute of Chartered Accountants in England and Wales most important institute form six of them. Also it has a privilege by the Royal Charter.[30]

During the Second World War, partly because of the dearth of fully qualified accountants, as many were conscripted for war service, the ICAEW announced that it had charged its Taxation and Financial Relations Committee to make recommendations on accounting practices. For many years the ICAEW continued to issue recommendations on accounting principles. By the late 1960s because of concern expressed in government and other circles, the accounting profession felt that it needed to put its own house in order. This concern was partly due to some apparently dubious practices found in takeover situations.[31]

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[29] Richard F. Kochanek & A. Douglas Hillman, **Financial Accounting**, Florida, Harcourt Brace Jovanovich, Inc., 1990, p. 570 - 573

[30] Necdet Şensoy, " **İngiltere'de Muhasebe Mesleği ve Muhasebe Kurumları"**, Muhasebe Dergisi, Marmara Üniversitesi Muhasebe araştırma ve Uygulama Merkezi, Aralık 1986, p.141

[31] Harvey & Keer,**op.cit.**, p.182

During 1970 the ICAEW issued their Statement of Intent on Accounting Standards in the Nineteen Seventies. This statement had a number of aims including to: encourage uniformity of practice in accounts; ensure the disclosure of accounting bases; disclosure any departure from an accounting base or policy; use an exposure draft principle; continue encouragement to improve legislation and regulations.[32]

The role of the Accounting Standards Board (ASB) is to issue accounting standards. It is recognized for that purpose under the Companies Act 1985. It took over the task for setting accounting standards from the Accounting Standards Committee (ASC) in 1990. [33]

The ASB has up to ten members. ASB meetings are also attended by two observers. Board members are appointed by the Appointments Committee of the Financial Reporting Council (FRC). FRC with its subsidiaries, ASB and Financial Accounting Review Panel (FRRP), together make up an organization whose propose is to promote and secure good financial reporting. Accounting Standards developed by the ASB are contained in 'Financial Reporting Standards' (FRS s). Soon after it started its activities, the ASB adopted the standards issued by the ASC, so that they also fall within the legal definition of accounting standards. These are designated 'Statements of Standard Accounting Practice' (SSAP s). Some of the SSAP s have been superseded by FRS s, some remain in force.[34]

Accounting standards apply to all companies and other kinds of entities that prepare accounts that are intended to provide a true and fair view.

The ASB' s objectives are set out in the ABS' s Statement of Aims. The aims of the Accounting Standards Board are to establish and improve standards of financial accounting and reporting, for the benefit of users, preparers and auditors of financial information. The Board intends to achieve its aims by:

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[32] **Ibid.**, p.182
[33] Internet Web Site: www.asb.org.uk. , "About the ASB"
[34] **Ibid.**

1. Developing principles to guide it in establishing standards and to provide a framework within which others can exercise judgement in resolving accounting issues.
2. Issuing new accounting standards or amending existing ones, in response to evolving business practices, new economic developments and deficiencies being identified in current practice.[35]

These are contained in the Board's Statement of Principles for Financial Reporting. Unlike its predecessor body, the ASC, the ASB can issue accounting standards on its own authority, without the approval of any other body. The ASB' s policy is to consult widely on all its proposals. Generally the development of a new accounting standard involves at least two formal consultation documents.

The ASB collaborates with accounting standard-setter from other countries and the International Accounting Standards Committee (IASC) in order to ensure that its standards are developed with due regard to international developments.

1.4. EUROPEAN UNION GAAP

Financial reporting requirements in Europe differ from those in the United States and other countries because of differences in their economies, relevance of local commercial law to the development of reporting standards.

The objectives of the Treaty of Rome (1957) include the establishment of the free movement of persons, goods and services and capital. This involves the elimination of customs duties, the imposition of common tariffs to third countries and the establishment of procedures to permit the coordination of economic policies. The Common Industrial Policy (1970) calls for the creation of a uniform business environment, including the harmonization of company law and taxation and the creation of a common capital market.[36]

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[35] Harvey & Keer, **op.cit.**, p.183
[36] Christopher Nobes & Robert Parker, **Comparative International Accounting**, Fifth Edition, Hertfordshire, Prentice Hall Europe, 1998, p.83

Within the European Economic Community (EEC), attempts have been made to reduce reporting differences. The Fourth directive (1978) attempted to provide a framework for a common level of disclosure, with an emphasis on accounting rules and measurement methods. This directive permitted some choice as to format and required content of the balance sheet and income statement and did not mandate a cash flow statement.

The reasoning behind these objectives includes the fact that the activities of companies extend beyond national frontiers and that shareholders and others need protection throughout the EU. In order to achieve this and to encourage the movements of capital, it is necessary to create a flow of reliable homogeneous financial information about companies from all parts of the EU. Further, since companies in different EU countries exist in the same form and are in competition with each other, it is argued that they should be subject to the same laws and taxation.[37]

Within the European Economic Community (EEC), attempts have been made to reduce reporting differences. The Fourth Directive' s first draft published in 1971. In this initial draft, valuation rules were to be conservative, formats were to be prescribed in rigid detail and disclosure by notes was to be very limited.[38] The Fourth directive (1978) attempted to provide a framework for a common level of disclosure, with an emphasis on accounting rules and measurement methods. This directive permitted some choice as to format and required content of the balance sheet and income statement and did not mandate a cash flow statement. This directive was a preliminary attempt at harmonization and its adoption followed the passage of the directive into law in each member country.[39]

It is clear that neither asset valuation, nor formats, nor disclosure have been completely standardized as a result of the laws consequent upon the Fourth Directive. Several countries have made legal changes which are strongly influenced by the Directives, partly as preparation for possible membership of

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[37] **Ibid.**. p.83
[38] **Ibid.**, p.85
[39] White, Sondhi & Fried, **op.cit.** , p.14

the EU. Members of the European Economic Area are also obliged to implement the Directives.[40]

In 1983, the EEC issued the Seventh Directive with an efficient date of January1, 1990. This directive is similar to international practice, particularly in the requirement for consolidated financial statements.[41]

The EU achieves its harmonizing objectives through two main instruments: Directives, which must be incorporated into the laws of member states; and Regulations, which become law throughout the EU without the need to pass through national legislatures.[42] It is particularly the fourth and seventh Directives on company law that have been affecting accounting in Europe. The fourth Directive has caused important changes in most EU countries in formats of accounts or disclosure or valuation procedures. The seventh Directive has achieved a significant degree of harmonization of group accounting.[43]

Harmonization in Europe may provide to be difficult if only because of critical differences between U.K. and German GAAP. It is quite likely that the European Union will foster greater cooperation between standard setting organizations across Europe and thereby contribute to international harmonization. It is better to take the form of adoption of IASC standards rather than European Union GAAP.[44]

The Lisbon European Council Conclusions have underlined the importance of an efficient and transparent capital market for fostering growth and employment in the EU. Globalization and information technology developments have created a unique momentum to realize a single, efficient and competitive EU securities market. In order to accelerate the completion of a single securities market, urgent action in the field of financial reporting is required to enhance comparability of financial statements, as requested by

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[40] Nobes & Parker, **op.cit.**, p.86
[41] White, Sondhi & Fried, **op.cit.** , p.14
[42] Nobes & Parker, **op.cit.**, p.83
[43] **Ibid..**, p.88
[44] White, Sondhi & Fried, **op.cit.**, p.14

the European Council in Lisbon. The European Commission's Communication on "EU Financial Reporting Strategy: the way forward", was released on 13 June 2000. This Communication includes the following key proposals:

- Before the end of 2000, the Commission will present a formal proposal requiring all listed EU companies to prepare their consolidated accounts in accordance with IAS. This requirement will enter into effect, at latest, from 2005 onwards. Member States will be allowed to extend the application of IAS to unlisted companies and to individual accounts.
- Before the end of 2001, the Commission will bring forward a proposal to modernise the Accounting Directives so they can remain the basis for financial reporting for all limited liability companies.[45]

1.5. TURKISH GAAP

In the period of republic until 1960, Turkish accounting system had been influenced by the German accounting system. The accounting system, which was prepared for Sümerbank began to be applied by most of the State Economic Enterprises (SEE, in Turkish KİT). First seminar on launching a Uniform Accounting System for State Economic Enterprises was arranged in 1969. Uniform Accounting System was starting to implement in several State Economic Enterprises from 1969 to 1972. Since 1972, Uniform Accounting System for State Economic Enterprises began to be applied.[46]

Turkish Capital Market Board (CMB, in Turkish SPK) published financial statement forms in early 1983 and uniform chart of accounts in early 1984 for its associated companies. Accounting standards of Capital Market Board was established in 1989. After the applications in CMB, accounting system began to be unified. In 1993 Uniform accounting System which was published by Ministry of Finance and Customs became effective.[47]

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[45] Internet Web Sitesi: www.pricewaterhousecoopers.com , "EU financial reporting"

[46] Ahmet Kızıl, **Muhasebe Prensipler ve Uygulama,** Üçüncü basım, İstanbul, Der Yayınları, 1991, p.5
[47] **Ibid.**, p.5

Since then, necessity of accounting standards became more evident. To satisfy this necessity, in 1994 Turkish Accounting and Audit Standards Committee (TAASC, in Turkish TMUDESK) was set up by the Turkish Accountants Chamber Union (TACU, in Turkish TURMOB). [48]

In 1999, according to the supplement article 27 of the Turkish Capital Market Law number 4487, Board of Accounting Standards is established under Prime Ministry. [49]

1969 --- First seminar on launching a uniform accounting system for State Economic Enterprises

1972 ---- A uniform accounting system for State Economic Enterprises began to be applied

1983 ---- Turkish Capital Market Board published financial statement forms

1984 ---- Turkish Capital Market Board published a uniform chart of accounts for its associated companies

1989 ---- Legislation about accounting standards was established by Turkish Capital Market Board

1993 ---- Uniform accounting system was published by Ministry of Finance and Customs and became effective

1994 ---- Turkish Accounting and Audit Standards Committee was set up

1999 ---- Board of Accounting Standards is established under Prime Ministry

Uniform Accounting system which was established by Turkish Ministry of Finance & Customs Turkish Tax Procedural Code, includes;

1. Fundamental Accounting Principles (Assumptions & Considerations)
2. Disclosure of accounting policies
3. Principles of financial statements
4. Explanations about the financial statements which must be prepared

[48] TMUDESK ,**Türkiye Muhasebe Standartları 1997,** İkinci Baskı, Ankara, 1997, p.i
[49] Sermaye Piyasası Kanununda Değişiklik Yapılması, Kanun No.4487, Madde 27 Ek Madde 1, Lebib Yalkım Yayımları, R.G. Tarihi 18.12.1999, p.1(a)

5. Framework of Uniform Chart of Accounts & Chart of Accounts with brief explanations on accounts[50]

This committee is similar to other committees in Europe and Unites States. It is also harmonious with international accounting standards. Information users of the entire accounting environment are represented in this autonomous committee.

Objectives of the TAASC are to realize the uniformity in accounting principles, which are based on to report financial statements for entities and other foundations in all around the country and to determine the audit standards for the members of the professions.[51]

The target objective of forming the accounting standards by the TAASC is the same with the objectives of International Accounting Standards Committee (IASC). The objectives to determine the accounting standards are as follows;
1. To develop and establish the accounting standards about the basis of reporting and presenting the financial statements. To make the standards be accepted and applied in all the country.
2. To work for the harmonization of the methods and standards with subjects under discussion about presenting and preparing the financial statements.

Although confirming the statements through the Turkish accounting standards, Turkish uniform accounting system and Turkish capital market board' s accounting regulations, the financial statements should be prepared according to the Turkish Tax Law.

The financial statements according to the Turkish Uniform Accounting System should abide with the following accounting principles:

a) Principles about the expenses and revenues,
b) Principles about assets,
c) Principles about liabilities
d) Principles about owner's equity.

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[50] Necdet Şensoy, **Selected Topics on Turkish Tax Accounting,** İstanbul, Marmara Üniveritesi Yayın No:550, 1994, p. 125

[51] Bayazıtlı Ercan, **Türkiye Muhasebe Standartları 3 ve 4 Uluslar arası- A.B.D.- İngiltere Muhasebe Standartları Karşılaştırması**, İzmir, İzmir SMM Odası Yayın no.1, 1997, p.2

Principles about expenses and revenues are as follow;[52]

1. Unearned revenues, income and profit should not be accounted as they are earned or less or more than its real amount.
2. Cost of goods sold and expenses for a defined period should only be matched with revenues and sales of the same period.
3. An accurate amount of depreciation, amortization and depletion should be provided for tangible, intangible fixed assets and natural resources.
4. Costs should be distributed suitably between the tangible fixed assets, inventories and related expenses.
5. Extraordinary and abnormal expenses and revenues should be accrued the time when they occur and should be accounted and reported distinctly from the ordinary expenses and revenues.
6. All of the expenses and revenues should be reported in the statement.
7. Reserves and allowance having the same characteristic with reserves should not be used to decrease the income of the period and to transfer the profit to next period.
8. Changes in the valuation methods and cost systems should be disclosed in the footnotes to the income statement.
9. Expenses and losses that are expected to be occurred, as results of a contingent event but values are uncertain should be accrued with their estimated value.

Principles about assets are as follows:

1. Assets that can be converted into cash or cash equivalent in one year should be presented among the current assets. For doubtful receivables, allowance should be provided. Inventories should be valued at the lower of their cost or market value.
2. Investments and affiliates should be shown with their paid or unpaid capital value. The value of paid in capital should be shown as subtracted unpaid capital from the capital.
3. Tangible assets should be recorded with their cost value. The period to use these assets should be more than one year.

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[52] Kızıl, **op.cit.,** p. 11- 14

4. An accurate depreciation should be provided for tangible assets and this value should be reported as the difference of historical cost value and accumulated depreciation.
5. Intangible assets should be reported with their cost value.
6. The nature and limits of the “pledged assets” should be disclosed in the notes of the balance sheet.
7. The amount of receivables, which are uncertain, should be disclosed only among the footnotes and appendix of the balance sheet.

The principles about liabilities are;
1. All of the entity' s debts should be reported.
2. The liabilities should include all of the debts of the business entity, which will be paid in one year. Short-term liabilities should be classified according to the kind of the transactions.
3. Revenue collected in advance and payables for accrued expenses should be presented in the balance sheet.
4. Long term liabilities are the debts to be paid in longer than one-year period. Long- term liabilities should be presented separately from the short-term liabilities.
5. Mortgage and pledged debts should be disclosed in detailed conditions of the collateral in the footnotes of the balance sheet.
6. All of the contingent liabilities should be presented in the footnotes of the balance sheet.
7. If the maturity date of the note payables is not dued, they should be valued after the rediscount value is accounted and should be presented with their real value in the balance sheet.
8. The debts among the short and long-term liabilities, which are owed to the partners, staff, affiliates and subsidiaries, should be disclosed separately.

The principles about the owner's equity are in the following;
1. The share-capital should be classified according to the types of shares. Paid-in capital of the entity should be reported as a separate account in the balance sheet.

2. Losses should be disclosed according to the periods which occur and cumulatively.
3. Retained earnings that is the cumulative total of the income remains to the entity after subtracting the dividends from the income for the period.
4. The decrease in the accumulated loss, loss of the period and decrease in the equity should be presented under Shareholders Equity cumulatively and periodically and as decrease from the declared capital.
5. The increases in the value of assets as a result of revaluation of assets (which is permitted by legal authorities) should be disclosed as a surplus among shareholders equity.
6. The privileges to the employees and shareholders should be disclosed obviously.
7. Shareholders equity comprises, paid-in capital, capital reserves, profit reserves, retained earnings, accumulated losses, net profit or loss for the period.

1.6. CAUSES OF INTERNATIONAL DIFFERENCES

There are major differences in accounting practices. In this case it is important to define accounting. We can define accounting as annual financial reporting by companies. Other term can use be used in this area that is accounting system. Accounting systems can be defined as set of financial reporting practices used by a particular company for an annual report. Different companies in a country can use different accounting systems. The causes of differences are examined in the following.

1.6.1. External environment and culture

Its environment, including the culture of the country in which it operates affects accounting. Hofstede (1980) develops a model of culture as the collective programming of the mind which distinguishes the members of one human group from another. Hofstede argues that, much as a computer operating systems contains a set of rules which act as a reference point and a set of constraints to higher level programs, so culture includes a set of social values that drive institutional form and practice. [53]

To get some idea of the basic cultural patterns of various countries, Hofstede defined and scored the following four basic dimensions of culture:

1.6.1.1. Individualism versus collectivism

Individualism stands for a preference for a loosely knit social framework in society wherein individuals are supposed to take care of themselves and their immediate families only.

1.6.1.2. Large versus small power distance

Power distance is the extent to which the members of a society accept that power in institutions and organizations is distributed unequally. People in societies that have large power distance accept a hierarchical order in which needs no further justification.

1.6.1.3. Strong versus weak uncertainty avoidance

Uncertainty avoidance is the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. This feeling leads them to belief promising certainty and to maintaining institutions protecting conformity. Strong uncertainty avoidance societies maintain rigid codes of belief and behavior and are intolerant towards deviant persons and ideas. Weak uncertainty avoidance societies maintain a more relaxed atmosphere in which practice counts more than principles and deviance is more easily tolerated. It tries to control the future, which is unknown, or to let it happen.

1.6.1.4. Masculinity versus femininity

Masculinity stands for a preference in society for achievement, heroism, assertiveness and material success. Its opposite, femininity, stands for a

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[53] Nobes & Parker, **op.cit.**, p. 15

preference for relationships, modesty, caring for the weak, and the quality of life.[54]

Gray applies these cultural differences to explain international differences in the behavior of accountants and therefore in the nature of accounting practices. Gray developed the following pairs of contrasting 'accounting values':

- Professionalism versus statutory control;
- Uniformity versus flexibility;
- Conservatism versus optimism;
- Secrecy versus transparency.

The first two relate to authority and enforcement. Here Gray sees a clear contrast between the 'Anglo' culture area on the one hand and Asian areas on the other. The second two relate to measurement and disclosure. Here gray sees a contrast between the 'Anglo' and the Latin and Germanic cultures.

This approach may well be particularly useful for examining such issues as international differences in behavior of auditors. However, for financial reporting, the measure of cultural attributes seem vague and indirect, compared to the measurement of certain elements of the external environment of accounting, such as legal systems or equity markets. In order to use cultural data in an accounting context, it is necessary to rely on the data collected from time to time by researches in other fields and for other purposes.

Another way of looking at the environment of accounting is to identify potential influences such as legal systems, corporate financing, tax systems and so on. These interact with culture in a complex way and seem to affect the style of financial reporting and accountancy profession that a country has.

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[54] **Ibid.,** p.16

When studying possible causes of accounting differences, it will also be useful to note that the environment of accounting may include the effects of imperialism. When predicting or explaining the accounting practices of many Asian countries, it may be more efficient to look at the colonial history rather than at other possible causes.[55]

1.6.2. Legal Systems

As we discussed in 'need of accounting standards', some countries have a legal system which relies upon a limited amount of statute law, which is then interpreted by courts, which built up large amounts of case law to supplement the statutes. Such a 'common law' system was formed in England. A common law rule seeks to provide an answer to a specific case rather than to formulate a general rule for the future. Although this common law system emanates from England, it may found in similar forms in many countries influenced by England. This naturally influences company law, which traditionally does not prescribe rules to cover behavior of companies and how they should prepare their financial statements. To a large extent, accounting within such a context is not independent upon law. Instead, accountants themselves establish rules for accounting practice, which may come to be written down as recommendations or standards.[56]

Other countries have system of code law, which is based on the Roman law. Common law is a system, which includes certain judges and interpretations. In contrast with the code law is also a system, which includes all situations detailed and instructively. The effects of legal systems are noticed in existing, determining and interpretation of accounting principles.[57]

Accounting principles are changed according to the changes in legal systems, because of the effects of legal systems in determining accounting

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[55] **Ibid.**, p.17

[56] **Ibid.**, p.18

[57] J.M. Samuels, R.E. Brayshaw & J.M. Craner, **Financial Statement Ananlysis in Europe**, U.S.A., Chopman & Hall Inc., 1995, p.70

policies. The cause of differences in disclosing the financial statements is the changes in the accounting policies.

Table 1.1 illustrates the way in which developed countries' legal systems fall into these two categories.

Table 1.1. Western Legal Systems

Common Law	Code Law
England and Wales	France
Ireland	Italy
United States (Federal)	Germany
Canada	Spain
Australia	Netherlands
New Zealand	Portugal
	Japan (commercial)

Source: Nobes & Parker, Comparative International Accounting, p.18

1.6.3. Providers of Finance

The prevalent types of business organization and ownership also differ. In Germany, France and Italy, capital provided by banks is very significant, as are small family-owned businesses. By contrast, in United States and the United Kingdom, there are large numbers of companies that rely on millions of private shareholders for finance. The comparison between the United states or United Kingdom and Germany or France is instructive. A two group categorization of these countries is almost as obvious as that for legal systems in Table 1.1.

Directives, which are issued by the European Economic Community, are regarded to harmonize the capital market practices. Capital market, which come into light in Europe, has a structure to support the harmonization of European accounting.[58]

1.6.4. Taxation

Although it is possible to make groupings of tax systems in a number of ways, only some of them are of relevance to financial reporting. For example, it is easy to divide EU countries into those using 'classical' and those using 'imputation' systems of corporation tax. However, this distinction does not have a major effect on financial reporting. To some extent this is seen in a negative way by studying the problem of deferred taxation, which is caused by timing differences between tax and accounting treatments. In the United Kingdom and the United States, the problem of deferred tax has caused much controversy and a considerable amount accounting standard documentation. Turning to France or Germany, it is found that the problem is minor; for in these countries it is largely the case that the tax rules are the accounting rules. In Germany, tax accounts should be the same as the commercial accounts. [59]

In some countries, preparation of accounts and records should be in the frame of tax laws. This main fundamental is in common use in Germany. Laws in some countries are permitted in selecting accounting policies.[60]

One obvious example of the areas affected by this difference is depreciation. In the United Kingdom, the amount of depreciation charged in the published financial statements is determined according to custom established over the last century and influenced by the accounting standard SSAP 12. "The standard points out that; depreciation should be allocated to accounting

[58] John Blake & Oriol Amat, **European Accounting,** London, Pitman Publishing, 1993, p.15
[59] Nobes & Parker, **op.cit.**, p.22

[60] Blake & Amat, **op.cit.** , p.12

periods so as to charge a fair proportion of the cost or valuation of the asset to each accounting period expected to benefit from its use".[61]

The amount of depreciation for tax purposes in the United Kingdom is quite independent of these accounting figures. It is determined by capital allowances, which are a formalized scheme of tax depreciation allowances designed to standardize the amounts allowed and to act as investment incentives. At the opposite extreme, in countries such as Germany, the tax regulations lay down maximum depreciation rates to be used for particular assets. These are generally based on the expected useful lives of assets. In some cases, accelerated depreciation allowances are available. If these allowances are to be claimed for tax purposes, they must be charged in the financial accounts.[62]

1.7. MAJOR INTERNATIONAL DIFFERENCES IN FINANCIAL REPORTING

1.7.1. Fairness

The degree to which accountants and auditors search for 'fairness' as opposed to correctness or legality has differed substantially across countries.

The law of the United Kingdom was alone in the EU in requiring fairness or faithfulness from audited financial statements. On one hand this elevates judgement of particular circumstances above uniform rules, but on the other hand it can be a more onerous requirement for directors and auditors. It can, of course, also lead to the abuse of flexibility by directors because of the vagueness of 'fair'.

The requirement of the EU' s Fourth directive that 'true and fair' should override detailed rules in all member states may lead to a mask of uniformity that conceals the unchanged old differences. This may make matters worse

[61] Nobes & Parker, **op.cit.**, p.22
[62] **Ibid.**, p.22

for Anglo-Saxon readers of financial statements, who may be misled by the increased superficial similarities.[63]

A related concept is 'substance over form', an expression usually associated with the United States. In attempt to 'present fairly' US accountants were the first to come to the view that it is necessary to try to account for the economic substance of events rather than for the legal form.

In great contrast to all this is the example of Germany where there is still no legal preference for fairness over rules, or for substance over form. Financial reporting is still an exercise in accurate bookkeeping, which must satisfy detailed rules and the scrutiny of the tax inspector. The recent requirement for German accounts to be 'fair' has been met by extra disclosures rather than a change in the presentation of numbers in the financial statements.

1.7.2. Conservatism and accruals

Another traditional adversary of fairness is conservatism. Conservatism is of different strengths because of the different mix of users in differing countries. For example, the importance of banks in Germany may be a reason for greater conservatism in reporting. A consequent lack of interest in a 'fair' view reduces the importance of the accruals convention which would normally modify conservatism.[64]

In the United Kingdom it is now more usual to refer to the concept of 'prudence'. In many cases, accounting standards are the compromise treaties which settle a battle between conservatism and the accruals concept.[65]

The protection of creditors is the use of statutory or legal reserves in several countries. These are as an another example, consider the allowance for reserves. In both of these nations, regulations exist to require that a defined

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[63] Roger K. Doost & Karen M. Ligon, "How U.s. and European Accounting Practices Differ", Management Accounting, October 1986
[64] **Ibid.**, p.31

[65] **Ibid.**, p.32

percentage of earnings (currently %5) be appropriated to a legal reserve account, until that account equals a defined amount (%10 of share capital in France, %10 of the par value of share capital in Germany, in general)[66]

1.7.3. Allowances and reserves

The distinction between allowances and reserves is important for financial reporting because the former are charges against profit, whereas the latter are appropriations of profit. The influences which lead to a proliferation of significant allowances appear to be conservatism and rigid but generous tax regulations. The result of such allowance accounting may be that the accruals convention and 'fairness' are partially overridden; this in turn may result in income smoothing. [67]

The use of accelerated depreciation in the financial accounts is an example of over-allowance. The lack of allowance for bad debts in a system where it is not allowed for tax purposes is an example of under-allowance. Allowances for risks and contingencies which fluctuate in reserve relationship with profits are examples of income smoothing. This may be illustrated using annual reports of French and German companies.[68]

In the United Kingdom and United States, allowances for general risks are not supposed to be set up, and therefore income should not be smoothed by changing their size. Also, allowances for depreciation and bad debts are not supposed to be affected by tax regulations. Nevertheless, a precise definition of allowances has still not been settled by the standard setters.[69]

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[66] Epstein & Mirza, **op.cit.**, p.6

[67] Nobes & Parker, **op.cit.**, p. 33

[68] **Ibid.**, p.34

[69] **Ibid.**, p.34

1.7.4. Valuation bases

Historical cost method is used in valuing and reporting most assets and liabilities. So the balance sheet does not reflect the current value of many items. When a balance sheet is prepared in accordance with generally accepted accounting principles, most assets are valued at cost ; exceptions are receivables and most investment securities.[70]

Many believe that all assets should be restated in terms of current values; there are, however, widely different opinions about the type of valuation basis to be employed. Some contend that historical cost statements should be adjusted for constant dollars (general price-level changes) when inflation is significant; others believe that a current cost concept (specific price-level changes) is more useful; still others believe that a net realizable value concept or some variant should be adopted. [71]

There is great international variation in the predominant basis of valuation and the degree to which there is experimentation and supplementation with alternative measures. In a country with detailed legal rules and a coincidence of tax and commercial accounting it must be expected that the predominant valuation system will be the one that involves as little judgement as possible. Flexibility and judgement would make it difficult for auditors to determine whether the law had been obeyed and might lead to arbitrary taxation demands. Thus, in a country such as Germany, it seems unsurprising that the required method of valuation is a strict form of historical cost. This also fits with the German opposition to inflation, resulting from the scarring experience of hyper-inflation in the post-war periods. [72]

United Kingdom 'rules' allow a chaotic state of affairs where some companies revalue, some of the time, using a variety methods. Also, there has been experimentation with current cost accounting, normally as supplementary

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[70] Kieso & Weygandt , **op.cit.**, p. 205

[71] **Ibid.**, p.205

[72] Nobes & Parker, **op.cit.** , p.34

statements. But United States keeps to historical cost in the main financial statements; this is because of the influence of the SEC.[73]

In France, Spain and Italy, where there is much tax and other government influence, there has also been more inflation than Germany and a drive towards the creation of large and efficient equity capital markets. Governments and stock exchange bodies in these countries have appreciated the effects of inflation on historical cost accounting and have required revaluation. However this creates severe problems in such countries.[74] Although the historical cost accounting is the basic of the reporting, securities, immovable, land, materials and inventories are valued with current cost accounting.[75]

Many countries, notably in South America, have adopted forms of general purchasing power (GPP) adjusted accounting. This has occurred in countries with very high inflation, government/ tax controlled accounting, and a paucity of accountants. Thus GPP satisfies the requirements of simplicity and uniformity, as a single inflation index can be used by all companies. GPP accounting is of course basically historical cost accounting with 'last minute' annual indexations.

1.7.5. Consolidation

Consolidation is to bring together two or more companies' s financial statements, which are managed and audited with same common groups to evaluate the financial situation and working results with a combining technique.[76]

The prevalence of consolidation has varied dramatically around the world. Most practices seem to have first enjoyed widespread adoption in the United

[73] **Ibid..**, p.34
[74] **Ibid..**, p.35
[75] Joe B. Hoyle, **Advanced Accounting**, Third Edition, Boston, Irwin Inc., 1991, p.625
[76] Güvemli Oktay, "Kurumlar Topluluğunun Muhasebe Finansman, Vergi ve Ticaret Hukuku Açısından Yönetimi", Marmara Üniversitesi Nihad Sayar Eğitim Vakfı, Yayın No: 451/684, 1993, p.37

States: for example, the normal acquisition method, the equity method and the pooling of interests / merger method. [77]

When the equity method is used, an investment in common stock is first recorded at cost but later is adjusted each year for changes in the stockholders' equity in the investee. As the investee earns net income, the stockholders' equity in the company increases. An investor using the equity method recognizes its proportionate share of the investee's net income as an increase in the carrying value of its investment. A proportionate share of a net loss reported by the investee is recognized as a decrease in he investment. Investment accounted for by the equity method are not adjusted to the lower of cost or market value. In effect, the equity method causes the carrying value of the investment to rise and fall with changes in the book value of the shares. The purchase of an entire corporation usually is a very big investment. To accumulate the money necessary to buy another corporation, the parent company often needs to issue capital stock or bonds payable. If the parent company pays cash or issues debt securities to purchase the other corporation' s capital stock, the business combination is accounted for by the normal acquisition method. Other method used in consolidation is the pooling of interests / merger method. The pooling method may be appropriate if the stock of a subsidiary is acquired in direct exchange for shares of the parent company' s capital stock. A key aspect of such a transaction is that the former stockholders of the subsidiary become stockholders in the parent corporations. [78]

When we pay attention to the contents of the consolidation in the countries, we may see assortments in their contents. United States is distinct from other countries because of the process of the consolidation is very long and early developed. The various factors that might have caused this early development in the United States, these factors may have seen as follows:

[77] Nobes and Parker, **op.cit.**, p.35

[78] Walter Meigs , Robert Meigs , Accounting: The Basis for Business Decisions, Eleventh Edition, McGraw-Hill Publishing Company, 1999, p. 645-649

- The prevalence of the holding company as opposed to the parent company
- The lack of a legal requirement for holding / parent company balance sheets,
- The lack of a legal or other barriers to the emergence of new techniques and existence of innovative professionals,
- The use of consolidation for tax purposes (1917 to 1934)
- Acceptance of consolidation by the new York Stock Exchange (1919).[79]

In the United Kingdom consolidation came later. Holding companies were perhaps less important until the First World War. Also, tax computations never moved to a consolidated basis in the United Kingdom. The 1928 act contained no consolidation requirements; the Stock Exchange required consolidation as a condition of new issues from 1939.[80]

In the United Kingdom, consolidated financial statements were seen as supplements to parent company balance sheets, whereas they were seen as substitutes in the United States. This may be because of the greater importance of holding companies and the lack of requirements for parent/holding company accounts in the United States. In the United Kingdom, consolidation grew up as a device to show investments in more detail than at cost, particularly as private subsidiaries were exempt from publication requirements.

The most continental European countries consolidation so far behind the United States and United Kingdom. The reason may include the following:

- The existence of many legal requirements that made the preparation of individual company balance sheets compulsory and militated against new ideas.
- The lack of a large and strong profession to innovate.
- The lesser importance of 'big business' and holding companies.

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[79] Nobes & Parker, **op.cit.**, p.36-37

[80] **Ibid.**, p. 37

- The importance of bankers and creditors who might oppose consolidation on the grounds that it confuses legal liabilities.
- The importance (as users of accounts) of the tax authorities and in some cases governments, who prefer to do their own manipulations of the accounts of individual companies.
- The relative lack of importance of shareholders who may want an overall 'economic' view.[81]

One of the effects of this rarity of consolidation was that the EU' s major draft law on financial reporting (the fourth directive) was adopted in 1978 without any recognition of group accounting.[82]

The stock exchange bodies and governments of most EU countries took actions to require listed or public companies to consolidate. This was designed to make their domestic capital markets more efficient and to internationalize the flows of capital. It is of course logical that to direct the consolidation rules at those companies where outside providers of finance are important. In addition, the Seventh Directive of the EU required consolidation rules by 1990.[83]

In the International Accounting Standards, all of the domestic and foreigner connected companies should make consolidation except some special situations. These special situations are

- Regulations are not temporary.
- Long period limitations should not be upset the audit.
- Companies' s activities should not be different from each other.[84]

In preparing the consolidated financial statements, two special accounting problem is rising. First one is currency translation. Foreigner companies prepares their statements in their domestic currency. The exchange rates

[81] **Ibid.**, p. 38

[82] **Ibid.**, p. 38

[83] **Ibid.**, p. 38

[84] Hoyle,**op.cit.** , p.626

between the date of the transaction and the date that the amount is paid. This fluctuation in the exchange rate will cause the parent company to experience either a gain or a loss in the settlement of the transaction. Second problem is principles of the accounting. General accepted accounting principles varies from country to country. Because of that reason operations of the joint enterprises are required to prepare their consolidated statements according to their income tax laws or accounting principles.

1.7.6. Uniformity and accounting plans

Uniformity is being compliance with comparative information. Uniformity effects the comparative information. The degree of confidence to the comparative information is based on the level of the uniformity in the financial statements.[85]

The degree to which financial reporting is uniform among companies within a country varies. When the EU' s harmonizing measures began to take effect, the variations were greater. Uniformity can exist in the three main areas: formats of financial statements, accounting principles and disclosure requirements. Clearly, where there are detailed legal rules in any or all of these areas, there will be a high degree of uniformity. [86]

In Anglo –Saxon countries there has generally been much less uniformity in areas of formats and presentation. As far as formats for financial statements are concerned, there were no rules in law for the generality of companies and virtually no rules on formats in accounting standards. The requirements of the Fourth Directive were based on German law and were revolutionary compared to previous Anglo-Dutch rules of this century. But even now there remains much more flexibility in the United Kingdom than in the rest of the EU; and US flexibility of formats and terminology is greater still.[87]

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[85] Harry I. Wolk, Jere R. Francis, Michael G. Tearney, **Accounting Theory**, Boston, Kent Publishing Company, 1984, p.172

[86] Nobes & Parker, **op.cit.**, p. 39

[87] **Ibid.**, p. 40

Turning to accounting principles, the control by company law, tax law or accounting plan has been substantial in most European countries. In the United Kingdom, there were traditionally no rules in the company law, apart from a version of 'fairness'. The accounting bodies and independent standard setters have made rules and laws based on Directives have been implemented. However, there is still plenty of flexibility in some areas, notably in the valuation of fixed assets.[88]

Flexibility is an important concept in pronouncing uniformity. Inflexible uniformity approach, to bring up certain formats that is used in the financial statements. On the other hand unlimited flexibility, making comparison become harder for users.[89] Both situations are unwilling for accountants.

The remaining potential area of uniformity is disclosure requirements. One difference between European and Anglo-Saxon practice is that companies in the former countries tend to restrict their disclosures to legal requirements, except when seeking to raise Anglo-American finance. In the United Kingdom and the United States, the basic disclosures required by law are substantial and lead to considerable uniformity. Other disclosures required by or recommended by standards or experimented with by individual company, are common. This leads to a certain degree of variation.[90]

1.7.7. Formats

Balance sheet varies in two main ways. (Table 1.2) First, in some countries, assets are displayed in order of decreasing liquidity (cash first), whereas in other countries there is an increasing order (intangible assets come first). The key to predicting this seems to be that the decreasing order is used by countries influenced by the United States and the increasing order is used by

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[88] **Ibid.**, p. 40

[89] Jan R. Williams, Keith G. Stange & William W. Holder, **Intermediate Accounting**, Fifth Edition, The Dryden Press, 1995, p.137

[90] Nobes & Parker, **op.cit.**, p. 40