

A STUDY FOR THE BEST PRACTICE OF THE NOTES UNDER IFRS - A COMPARISON OF PRACTICES BETWEEN GERMAN AND KOREAN COMPANIES

Bang, Kyung Won

Hankuk University of Foreign studies

Cho, Jang Youn (corresponding author)

Hankuk University of Foreign studies

ABSTRACT

The objective of this paper is to examine how one can represent the notes in the financial statements at their optimal form by the comparison of practices between German and Korean companies. After finding out common points and differences, the differences will be discussed further in respect of the specified companies and national regulations. After which then a suggestion for the best practices of notes disclosure will be made. Korea expanded the adoption of the IFRS to all listed companies starting this year, 2011. On the other hand, German companies have adopted IFRS since 2005 similar to other firms in EU. German firms have more experiences with IFRS in preparing, reporting as well as disclosing the financial information. In this paper, the checklist developed for evaluating the annual report by the Manager Magazine in Germany serves as a basis of comparison for the notes of two countries. Two checklist items, inventories and segment reporting, are chosen, since both issues are important and it is expected that there is much in common as for inventories and that there are differences as for segment reporting. The regulations for notes representation in each country, including the guideline of IFRS are introduced, followed by the check items for the quality of notes. Lastly, the results of comparison and the suggestions for the better practice of notes representation are discussed in the final section.

INTRODUCTION

Financial statements are prepared and disclosed for external users by many entities, such as publicly traded firms as well as privately held companies around the world. Although such financial statements may appear similar across countries, there are differences which have probably been caused by a variety of economic and legal circumstances. As the Conceptual Framework of Financial Reporting mentioned, these different circumstances have led to the use of a variety of definitions of the elements of and the scope of the financial statements and the disclosures made in them have also been affected by variety of country level. The International Accounting Standards Board is committed to narrowing these varieties for the external users, especially investors.

However, to check whether the goal of the framework is fulfilled and to see whether the commitment to reduce the varieties is fulfilled under different countries, we need to examine empirically actual practice of the firms of each country. We select two countries, Germany and Korea, since the former represent the country which adopt the IFRS early, while the latter country adopt the

IFRS fully from this year. The contents to be examined are centered around the notes, since the main body of financial statements is principle-oriented and so the notes can function as alternative standards. The notes contribute to understand the financial statements more in concrete explanation, since the preparer of financial statements can have more alternatives in accounting choices because of the IFRS' principle oriented nature.

Therefore, the notes become an integral part of financial statements compared to previous years under pre-IFRS periods. The study on the notes, however, is not so activated as on the other information set in the financial statements, and one of the reasons is tediousness of data collection. The objective of this paper is to examine how one can represent the notes in the financial statements at their optimal form by the comparison of practices between German and Korean companies. After finding out common points and differences, the differences will be discussed further in respect of the specified companies and national regulations. And a suggestion for the best practices of notes disclosure will be made.

Korea has accepted IFRS generally in 2007 by allowing large firms to adopt the IFRS early. And all the listed companies in Korea should adopt IFRS from this year, 2011. On the other hands, German companies have adopted IFRS since 2005 as other firms in EU. They have more experiences with IFRS in preparing, reporting as well as disclosing the financial information. Korea and Germany have some similarities in the economic situation. Both countries are export-oriented and several companies of each country are global market leaders. The faithful representation of financial information under the IFRS is a key qualitative characteristics to provide reliable and useful information to the market. In this respect, it is desirable for the market participants to understand the similarities and differences of related information of each other countries, and this paper will contribute to them.

Contrary to the other financial information set studies, there exist limited studies on the notes. Baetge has dealt with the theme on the notes partially in his book "Bilanzen" since 1991. Comprehensive studies on the notes come from Brüggemann(2007) and Armeloh(1996). These Studies are based on the empirical data of a questionnaire which checks out the interest of capital market.

In this paper, the checklist of Baetge for the notes serves as a basis of comparison of notes between two countries. This checklist was developed for evaluating the annual report on awarding of "The Best Annual Report of the Year" by the Manager Magazine in Germany. This Prize has a 20 years tradition and has been well received by many capital market participants as well as German companies. This checklist can be modified if there are any better suggestions or any reasonable considerations. Two items, inventories and segment reporting are chosen, since both issues are important and it is expected that there is much in common as for inventories and that there are differences as for segment reporting.

This paper is organized as follows. The regulations for notes representation in each country, including the guideline of IFRS is introduced in the second part, followed by the check items for the quality of notes. Lastly, the result of comparison and the suggestions for the better practice of notes representation are discussed in the final section.

REGULATIONS REGARDING NOTES

IFRS

The Framework of IFRS of Financial Reporting deals with a general principle on the preparation of notes. According to this principle, the following information should be discussed in the notes:

- Additional information on items of financial statements
- Information on risks and uncertainties which companies and their resources confront
- Information on off-balance sheet financing
- Information on segment reporting
- Information on the influence of inflation

IAS 1 deals with the presentation of notes. This standard suggests a reporting model for the notes as follows.

- To declare that the financial statements are prepared in accordance with the IFRS
- Accounting and valuation principles
- Additional information on individual items of financial statements in a systematic order
- Other information like contingent liabilities or non financial information like risk management goal and method of the company

The concrete contents to be involved in the individual items of financial statements are stated in each standard. Among them, the contents of notes for segment reporting are stated in IFRS 8. This standard covers for IAS 14 and adopts mostly the regulations of US-GAAP(SFAS 131). The classification of segments has to be made only by the operating segments and management approach.

GERMANY

In Germany, the commercial law (Handelsgesetzbuch, HGB) states the notes disclosure (§§ 284-288 HGB). In addition, other regulations like in AktG (Aktiengesetz), GmbHG (Gesetz betreffend die Gesellschaften mit beschränkter Haftung), DRS (Deutscher Rechnungslegungsstandard) are also involved. The notes can help to analyze the financial statements more in detail.

KOREA

In Korea, the full text of the notes is disclosed in auditor's report. This report is subject to "Corporate External audit Law" which regulates disclosure issues for all publicly traded firms as well as private firms with the asset size of over 10 billion Korean Won.

The country specific regulations are integrated sharply as the Korean firms fully adopt IFRS. So, the comparison will be made by the regulations of IFRS. In case of differences, they will be then discussed under consideration of country specific regulations.

COMPARISON BASIS

Comparison is a method to find out the differences, for these give further the motivation to discuss the problems to be improved. In order to systematize the comparison, the basis to compare has to be first prepared. This basis should be in a position to control the fulfillment of the obligations to be done and the interests of capital market. For this, the checklist for the notes disclosure which was developed by Baetge is of interest. His checklist was developed under consideration of German regulations and the interests of German capital market. This checklist will be consulted to compare the notes disclosure in this paper.

As discussed above, inventories and segment reporting are chosen to check the notes disclosure in the concrete.

Firstly, inventory checking points are as follows.

1. Production cost
 - 1.1. Interest on borrowed capital
 - 1.2. Allocation of direct production cost
 - 1.3. Capacity utilization
 - 1.4. Overhead cost
2. Allowance for bad debts under trade receivables
3. Method to measure inventories

The item for segment reporting will be checked on the basis of the following points:

1. Mandatory
 - 1.1. External revenue or internal revenue
 - 1.2. Segment operating profit
 - 1.3. Segment depreciation (or cash flow)
 - 1.4. Other items which have the influence on cash flow(or cash flow)
 - 1.5. Net profit from associates
 - 1.6. Other financial profit
 - 1.7. Segment assets
 - 1.8. Long-term investment
 - 1.9. Segment liabilities
2. Voluntary
 - 2.1. Additional results or earnings indicator
 - 2.2. Amortization of good will
 - 2.3. Elements of cash flow (cash flow from operating activity, cash flow from investment activity, cash flow from financing activity)
 - 2.4. Operating profit and expenses
3. Transferring of intersegment summation to balance sheet
4. Principles to eliminate intersegment transactions
5. Information of the prior year

RESULTS

GERMAN COMPANIES

10 German companies which have been awarded with the Price of “The Best Annual Report of the Year” by the Manager Magazine in Germany for the fiscal year 2010 are selected. The 10 companies are as follows: Deutsche Post AG, Adidas AG, Gildemeister AG, Wacker Chemie AG, RWE AG, K+S AG, ThyssenKrupp AG, Heidelberger Druckmaschinen AG, Drägerwerk AG & Co. KGaA, SolarWorld AG. Brief information on the consolidated basis is given in Table 1.

Table 1. Brief information on German companies

(Unit: KRW mil.)

	Assets	Sales	Net Profit	Employees
RWE	93,077	50,722	3,602	70,856
TK	43,712	42,621	927	177,346
DP	37,763	51,481	2,620	421,274
Adi	10,618	11,990	568	41,287
K+S	5,573	4,993	449	15,208
WC	5,501	4,748	497	16,033
HD	2,879	2,306	(228)	15,828
SW	2,635	1,304	87	2,140
DW	1,976	2,177	104	11,291
G	1,357	1,376	4	5,445

TK:ThyssenKrupp, DP:Deutsche Post, Adi:Adidas, WC:Wacker Chemie, HD:Heidelberger Druck, SW:Solarworld, DW:Drägerwerk, G:Gildemeister

As for the inventories, the most companies in the industry branch have disclosed about allowances for bad debts under trade receivables and inventory method. But the allocation of direct production cost and indirect cost is only verbal explained without citing figures.

Table 2. Results for the segment reporting of German companies

	RWE	TK	DP	Adi	K+S	WC	HD	SW	DW	G
1.1	O	O	O	O	O	O	O	O	O	O
1.2	O	O	O	O	O	O	O	O	O	O
1.3	O	O	O	O	O	O	O	O	O	O
1.4		O			O		O	O		
1.5	O	O	O			O				O
1.6	O	O	O			O		O		O
1.7	O	O	O	O	O	O			O	O
1.8	O	O	O	O	O	O	O		O	O
1.9		O	O	O	O	O			O	
2.1		O		O	O	O			O	O
2.2			O			O				O
2.3										
2.4	O					O	O		O	
3	O	O	O	O	O	O				
4			O		O	O	O		O	
5	O	O	O	O		O	O	O		O

TK:ThyssenKrupp, DP:Deutsche Post, Adi:Adidas, WC:Wacker Chemie, HD:Heidelberger Druck, SW:Solarworld, DW:Drägerwerk, G:Gildemeister

As appears out of table 2, the most German companies have good disclosed about the mandatory information.

KOREAN COMPANIES

10 companies whose annual revenue on the consolidated basis is for the fiscal year 2010 over 4,000 billion Korean Won (KRW) are checked. They are as follows: Samsung Electronics Co. Ltd., LG Electronics Inc., GS Caltex Corporation, LG Display Co., Ltd., LG Chem, Ltd., LG Uplus Corp., STX Pan Ocean Co., Ltd., SAMSUNG MOBILE DISPLAY CO., LTD., Samsung Kwangju Electro.VICS Co.,Ltd., SAMSUNG SDI CO., LTD.. Brief information on the consolidated basis is given in Table 3.

Table 3. Brief information on Korean companies

(Unit: KRW bil.)

	Assets	Sales	Net Profit
SS	134,288	154,630	16,1460
lge	32,318	55,753	1,282
lgd	23,857	25,511	1,159
GSC	22,845	35,315	862
lgc	12,673	19,471	2,199
lgu	8,525	8,500	570
SDI	7,933	5,124	385
stxp	6,005	6,469	78
SMD	4,289	4,446	350
SGE	1,156	4,040	11

KRW: Korean Won, SS: Samsung Electronics, lge: LG Electronics, lgd: LG Display, GSC: GS Caltex, lgc: LG Chem., lgu: LG Uplus, SDI: SAMSUNG SDI, stxp: STX Pan Ocean, SMD: SAMSUNG MOBILE DISPLAY, SGE: Samsung Kwangju Electro.

As for the inventories, the most companies in the industry branch have disclosed about allowances for bad debts under trade receivables and inventory method. But the allocation of direct production cost and indirect cost is only verbal explained without citing figures. The results are almost same as the ones of German companies.

Table 4. Results for the segment reporting of Korean companies

	SS	lge	lgd	GSC	lgc	lgu	SDI	stxp	SMD	SGE
1.1	O	O	O	O	O		O	O	O	
1.2	O	O		O	O	O	O	O		
1.3			O					O		
1.4										
1.5					O			O		
1.6					O			O	O	
1.7					O		O	O		
1.8					O			O		
1.9		O			O			O		
2.1										
2.2										
2.3										
2.4										
3										
4		O								
5										

SS: Samsung Electronics, lge: LG Electronics, lgd: LG Display, GSC: GS Caltex, lgc: LG Chem., lgu: LG Uplus, SDI: SAMSUNG SDI, stxp: STX Pan Ocean, SMD: SAMSUNG MOBILE DISPLAY, SGEC: Samsung Kwangju Electro.

As appears out of table 4, the segment reporting of Korean companies is mostly to seek so much as mandatory information, only with exceptions of LG Chem(lgc) and STX Pan Ocean(stxp). It is, above all, supposed that STX Pan Ocean has been familiar with IFRS, since it is listed in Singapore Exchange in 2005. At that time, it was compulsory that the company disclose the financial statements in accordance with IFRS. STX Pan Ocean has been now listed in Korea Exchange since 2007 and has adopted IFRS early in 2009. However, for the most Korean companies, the investors are hard to access the specific information for the segment reporting from the point of management approach.

Table 5. Comparison of both countries

	Germany	Korea
1.1		
1.2		
1.3		X
1.4		X
1.5		X
1.6		X
1.7		X
1.8		X
1.9		X
2.1	X	X
2.2	X	X
2.3	X	X
2.4	X	x

3		X
4		X
5		X

Table 5 shows the results of approximative comparison for the segment reporting of German and Korean companies. Korean companies offer only primitive informations like external or internal revenue and segment operating profit, while German companies provide more specific informations which fulfill the mandatory regulations.

In early stage of adopting IFRS, the learning processes should move forward overall. And it is judged that this work like in this paper will help to organize and accelerate that learning processes.

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