Impact of Globalization Versus Annual Reporting: A Case

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***Abstract*:** *This paper explains the impacts of globalization on annual reporting with few literature examples. Firstly, the impact of globalization has been explained, it includes the adoption of International Financial Reporting Standard (IFRS) to regulate annual reporting accounting procedure in each company. Moreover, the legal system of code law and common law in different subsidiaries countries will be identified and explained. Finally, finance and capital markets impact have been analyzed. Moreover, this paper shows how different international relationship impacts on annual reporting of companies. Globalization is a procedure of, whereby worldwide financial, political and social aspect is considered in a corporation. This help for creating nation's economy. For instance, globalization can impact monetary procedures, innovative advancements, political impacts, social and indigenous habitat components (H. Fairooz 2015). Therefore, globalization is crucial for Annual reporting to increase its shareholder value and impact the national economic improvement in developing countries over the world.*

Keywords: *Impact Globalization, Annual Reporting, Accounting Standard, A case*

1. Introduction

1.1. Significant of the Study

The Globalization is a process which business start operates on an international scale. Globalization caused by cross-country trade liberation and excessive technological advancements (E. C. Karadagli,2012). The company can globalize its business to expand the market, diversify in a different country and to increase profit. Accounting is frequently affected by a different environment which it operates (K. Cerne,2009). Hence, international accounting needed, which is a comparison of accounting in different nations and the accounting practices for international trades (Needles, 2010). Globalization and accounting are the interrelations where one business exposed to the opportunity and potential around the globe (S.Gallhofer and J.Haslam, 2006). In a global world, it encourages the firm to operate and widen the business to the countries worldwide. It is a good method for one firm to increase sales revenue and makes their good or services well known. However, in each international accounting diversity, there would be several impacts to the business itself which leads from some factors like rules and regulation, the source of finance, politic etc.

1.2. Statement of Problem, Methodology and Objective of Study

Globalization can be defined the process of an increase in the interconnection among people, corporations, and government bodies from all around the world resulted from tremendous international trading and overseas investment (G. Ritzer,2007). The development of advanced technology is believed to be the main driver leading to the acceleration of globalization process for the past decades (Z. Robert, Aliber, Reid W. Click 1993). Without the boundaries, multinational corporations (MNCs) were able to expand their business across the world easily, in the meantime, benefit from cheaper labor forces and supplies. The globalization process contains both positive and negative impact on an international company such as on any multinational company which will be discussed in detail further on. Hence objective of study comprises of the following paragraph :

“There are also differences in the flavor of impacts on the financial statements, for example, development costs, inventory value, statement of income and etc. In regards to the inventory value, GAAP allows companies to choose between last-first-first-out (LIFO) and first-in-first-out. On the other hand, IFRS does not allow companies to use LIFO. IFRS do not segregate extraordinary items in the income statement, while GAAP showed below the net income. In regards to development costs, when reached certain criteria, these costs can be capitalized under IFRS while, GAAP recognizes these costs as expenses (R.Forgeas,2008). However, IASB and FASB have been working together since 2002 to develop the convergence of GAAP with IFRS. This could help decrease the cost needed for reconciling to IFRS (R.Forgeas, 2008)”.

1.3. Literature, Discussion and Researcher’s View

Given the above statement and fact-finding, the following has been selected for our research as an impact of globalization on Annual Reporting of companies :

1.Generally Accepted Accounting Principle (GAAP) and International Financial Reporting Standards (IFRS)

2 Cultural Differences

3.Impact of Globalization- Adoption of IFRS (International Financial Reporting Standard)

4. Impact of Globalization- Nation’s Legal Systems

5. Accounting Regulations

6. Impact of Globalization- Finance and Capital market

1.4. The Method of the Study

1.4.1. Generally Accepted Accounting Principle (GAAP) and International Financial Reporting Standards (IFRS)

“IASB and FASB have been working together since 2002 to develop the convergence of GAAP with IFRS. This could help decrease the cost needed for reconciling to IFRS ”

In regards to the differences between GAAP and IFRS, conceptual approach is one of the major differences. GAAP is rule-based approach released by Financial Accounting Standard Board (FASB), while IFRS is principle-based approach released by International Accounting Standard Board (IASB). There are also differences in the flavor of impacts on the financial statements, for example, development costs, inventory value, statement of income and etc. In regards to the inventory value, GAAP allows companies to choose between last-first-first-out (LIFO) and first-in-first-out. On the other hand, IFRS does not allow companies to use LIFO. In this case, U.S subsidiaries might lose the advantage of using LIFO. In regards to the income statement, IFRS does not segregate extraordinary items in the income statement, while GAAP showed below the net income. In regards to development costs, when reached certain criteria, these costs can be capitalized under IFRS while, GAAP recognizes these costs as expenses (R. Forgeas,2008).

However, IASB and FASB have been working together since 2002 to develop the convergence of GAAP with IFRS. This could help decrease the cost needed for reconciling to IFRS (R. Forgeas,2008).

1.4.2. Cultural Differences

The culture from various countries differs in many ways such as the demand for product and services. The explanation of this circumstances is cultural differences between the countries. Based on the findings of annual reporting of several companies. Therefore, it can be seen companies have to make a wise choice to expand their business in different parts of the world. It is apparent that with extra efforts placed into research and understanding cultural differences, the international company could yield desirable return. Conversely, after obtaining sufficient knowledge on different culture from foreign countries will be able to avoid unnecessary expansion in the region with insufficient demand on their products.

1.4.3. The Impact of Globalization-Adoption of IFRS (International Financial Reporting Standard)

"Accounting regulation in each country is different such as different assets valuation methods, foreign currency translation, goodwill and more…"

This results in significant differences were recorded, but annual reporting needs comparable financial data in each country to examine performances. Hence, the International Financial Reporting Standard (IFRS) has been adopted to regulate international accounting policy and international stock exchange market. The IFRS adoption improves cross-country comparison of financial data, enhanced operation and globalization of capital market to access international capital to reduce investors' risks (V.M.Nguyen, 2006; Z. Wang et al 2016 and S. M. Wang,2004). Almost, the annual report must comply with IFRS because it's a globalized company. Thus, the international adoption of IFRS can have globalization impact on accounting practices of company's and its subsidiary companies in different countries. Besides, US didn't adopt IFRS. IFRS, administered by IASB uses principles-based or asset/liability approach and adopted in many countries. However, US adopt Generally Accepted Accounting Principles (GAAP) approach, administered by FASB used rules-based or income/expenses approach (T.Berndt and M. Hommel 2005). Thus, different accounting regulatory use in US company needs to pay attention insignificant difference in recorded information.

1.4.4. Impact of Globalization- Nation's Legal Systems

"Code law is all accounting and financial regulations are regulated and formulated by the government "

There are different types of legal systems: code law and common law. Common law is all accounting and financial regulations are regulated and formulated by independent professional bodies. Code law is all accounting and financial regulations are regulated and formulated by the government. Different legal systems in each countries impacts on Annual financial disclosure (A.K.Gyasi, 2010). The difference in code law and common law include legalistic or non-legalistic. Common law improves comparability of financial data than code law. For instance, China is under code law jurisdiction while Hong Kong is under common law jurisdiction (Z. Wang et al 2016and S.M. Wang, 2004). TWE has subsidiaries in both China and Hong Kong, hence the comparability of the financial reports in these countries is difficult because of different legal systems used. Moreover, different legal systems impact different accounting systems and accounting regulations in the different country. The accounting system in code law countries has rigid and procedural minimum requirement. While accounting system contains limits and professional judgment (include accountant and auditors judgment in interpreting accounting system and financial data) is permitted within the limits in common law countries (B. Jaggi and P.Y. Low 2000). Thus, Annual reporting has to identify legal system used for different regional subsidiaries because the company has to comply with the local legal system. Breaching legal system because misidentifies code law and common law such as not compliances of financial disclosure standard may impose penalties.

1.4.5. Accounting Regulations

"The differences between the two accounting policies would have significant impact on the reports such as inventory recording, write down on inventory, fair value measurement, and much more"

The difference in accounting policies and regulation give rise to a problem whereby the financial reports complied with GAAP could not be accurately compared to reports using IFRS. The differences between the two accounting policies and regulation would have a significant impact on the reports such as inventory recording, write down on inventory, fair value measurement, and much more (C.W. Nobes and C. Stadlar,2015). Hence, annual reporting is required remodel the financial reports to comply with IFRS for the purpose of preparing accurate consolidated financial statements as a group.

With respect to different accounting policies and regulation, the measurement of fair value will be examined to demonstrate the response of annual reporting.

1.4.6. Impact of Globalization- Finance and Capital Market

"Financial report has to design for the main user, that's shareholder because of asymmetry information available for them in daily business operation. Information will be more on company performance and dividend ".

"The sources of financing do result in diversity on international accounting practices. The sources of financing consist of equity-oriented and debt-oriented (M. Saudagaran, 2009)."

There are two sources of finance: equity and debt financing. Globalization impacts finance and capital market and both affect firm's accounting systems. Equity financing raises capital by selling company shares to investors or shareholders. Thus, financial report has to design for the main user, that's shareholder because of asymmetry information available for them in daily business operation. Information will be more on company performance and dividend (Y. Luo, 2008). Debt financing borrows loans from creditors or bank. Hence, financial report will be designed to provide information needed by creditors or bank such as liquidity, current ratio (A.N. Berger, A.N. Hassan, and M. Zhou, 2009). As most of the companies operate internationally, instead of debt financing they're more suitable to raise capital via equity financing to attract investors worldwide. Moreover, they are listed on several stock exchanges which enable the public offering of their share in the stock market. In return to shareholder investment, Company has to pay a dividend. Dividend information is disclosed in the financial and annual report as required. As Companies is having world-class branding, the good financial performance they easily raise equity financing on a worldwide basis.

The sources of financing do result in diversity on international accounting practices. The sources of financing consist of equity-oriented and debt-oriented (M. Saudagaran, 2009). A company is considered equity-oriented if it largely relies on issuing new shares to finance its capital. While a company is considered debt-oriented if its main source of capital is financing through borrowings from banks and financial institutions. In countries such as Australia, UK, and Canada, the capital markets are strong and share ownership of companies are more widely dispersed. However, in debt-orientated countries such as Japan, subsidiaries from these countries tend to finance their capital by borrowings from banks and financial institution. For these subsidiaries, the level of information asymmetric might be lower as companies are not under pressure for showing a better profit to attract investors.

2. The Results of the Study

Hence as a research discussion as a case we summarized following positive impacts of globalization on Annual Reporting :

Globalization can provide a certain level of isolation to business for slumping performance in one region. In other words, the global diversity of customer could help business to spread the business risk to a wider customer base. Due to this, if there is an issue in one region regarding economic, supply, environment, regulation and etc; that will negatively affect the business performance, the business still can get success in other regions International Financial Reporting Standards (IFRS) is worldwide accounting diversity provides challenges for international trade and investments (Ball, 6). However, generally accepted accounting principles (GAAP) is an accounting rule and standards of financial reporting administered by FASB. IFRS used in many countries while GAAP used in the US only. IFRS also can eliminate many international differences of accounting standards in order to make financial statements more comparable internationally and it may reduce investor risks. However, IFRS also has some limitations which are difficult for comparability as the difference in accounting culture, business and financial. In addition, fair value rules may not reflect local situations because of only some of the countries some or other reason.

3. Summary and Discussion of the Study

3.1. Conclusion

In brief, the adoption of IFRS, a nation's legal system and the finance and capital market are impacted by globalization. The adoption of IFRS regulates international accounting system of subsidiaries in different countries and should be complied except for US subsidiaries which use GAAP. Besides, the different legal system in different countries has to be identified and complied.

The companies should continue to monitor the changes of the various corporate tax rates for accurate consolidated tax expense valuations. The companies can make efforts in exploring the preference and behavior towards product and services. Overall, the current globalization impacts bring positive effects for annual reporting.

The companies are encouraged to follow international financial reporting standard (IFRS) because it is more cost-effective. Besides, it can provide several benefits to the company such as greater the capital markets to globalization and lower the transaction costs. Also, it will reduce the risk of investors through generated higher quality and more transparent accounting information. However, unlike GAAP, IFRS is not adopted by US companies. (J. Berndt et al, 2005).While, for the transactional exposure, it only has the limited effect on annual reports, but it helps the investors can easily to interpret the each segments' performance.

4. Recommendations from the Study Results

4.1. Future Direction

For future as a research case of annual reporting, we would like to state that Accounting diversity brings many problems to a company involved in global trade and many efforts have been made to reduce the accounting differences. An effort such as harmonization which means to have one set of international accounting standards that are practiced by all companies around the world would simplify the preparation of financial statements (T. Doupnik and H. Perera 2014, 33). It is recommended for companies to pursuit harmonization for a better financial disclosure with unified accounting standards so costs related to the preparation of accounts for a multinational corporation can be reduced. Yet, before the successful realization of harmonization, Companies should comply with the accounting standards of different countries where its subsidiaries operate to avoid any breach and violation that can harm the corporate image globally.

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