NEXIA GLOBAL INSIGHT

An international business briefing

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Financial reporting

US sounds out new IFRS approach

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Globalisation and the need to better compare financial statements have resulted in every major capital market moving towards international financial reporting standards (IFRS) – with the exception of the US. Yet businesses in the US do not operate in silos. The need to reconcile US accounting principles with IFRS has broad implications for businesses worldwide.

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Capital markets

London calling: why overseas companies join AIM

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Nexia updates definitive guide to international tax

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The latest development in the US approach to international financial reporting will have far-reaching implications for businesses around the world.

Globalisation and the need to better compare financial statements have resulted in every major capital market moving towards international financial reporting standards (IFRS) – with the exception of the US. Yet businesses in the US do not operate in silos.

There are over 2,200 US multinational parent companies with majority interests in foreign entities. These companies have around 24,000 foreign affiliates, each of which may have to report in their home country using local Generally Accepted Accounting Principles (GAAP) or IFRS. Similarly the 9,000 entities around the world that own interests in close to 12,000 US companies have to use GAAP or IFRS in their home country, which can have a huge impact on the US entity. It is clear then that the need to reconcile US accounting principles with IFRS has broad implications for businesses worldwide.

These differences in financial reporting relate to revenue recognition, fair value accounting, accounting for leases, and share-based compensation, all of which can impact significantly on business practices. IT systems, internal controls, reward structures, disclosure and investor relations can also be affected.

New ‘condorsement’ approach
Little wonder then that last month the US Securities and Exchange Commission (SEC) called for comments on its recommended “condorsement” approach to incorporating IFRS into the US financial reporting system.

Condorsement – essentially moving towards convergence while continuing IFRS endorsement – would mean the incorporation of IFRS principles into US GAAP over a defined period of time, say five to seven years. Each IFRS would be evaluated individually and incorporated only when newly issued or unlikely to be modified in the short term. The timing and manner of transition has yet to be decided.

Gradual implementation would potentially:

- avoid the costs associated with a “big bang” incorporation
- allow for a harmonised approach, mitigating the occasions when US businesses might be required to make accounting changes in quick succession
- present the opportunity to develop a more comprehensive educational process, as fewer new standards would be coming through.

What next?
The SEC has emphasised that it has yet to make a final decision on how to incorporate IFRS into the US financial reporting system and is inviting feedback from professional advisers.

However, due to the prominence of US GAAP references in US law and regulatory material, it is proposing that IFRS is incorporated into US GAAP, which would remain the basis of financial reporting for US businesses. Ultimately however, a US business that meets US GAAP will be compliant with IFRS as issued by the IASB.

Whether or not this announcement means that the US is committed to incorporating IFRS fully remains to be seen. What is clear is that any US business with an international outlook or any business worldwide with US interests will need to continue to monitor closely changes to US GAAP until it is fully aligned with IFRS.

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Financial reporting

IFRS for SMEs – slow road to adoption

The introduction of a set of international financial reporting standards (IFRS) designed specifically for small and medium-sized enterprises (SMEs) has made IFRS potentially accessible to a huge number of companies around the world.

The International Accounting Standards Board (IASB) published the new rules in July 2009 in response to international demand for a rigorous and common set of accounting standards for SMEs that is much simpler than full IFRS.

With 95% of the world's companies falling within the IASB's definition of an SME, the goal is to provide internationally comparable financial statements that will both improve confidence in their worth and reduce the costs involved in maintaining them.

At the same time, IFRS for SMEs aims to reduce the reporting burden by simplifying the method of recognising and measuring assets and liabilities, omitting topics not relevant to SMEs and cutting the number of required disclosures.

Slow take-up

According to the IASB, almost 60% of accounting standard setters plan to require or permit the use of IFRS for SMEs within their jurisdiction in the next three years. But the five years it took to develop the standards could now be followed by years of slow take-up across the globe.

Research that Nexia International has conducted into IFRS adoption shows that many smaller companies may not adopt the new standards for their financial reports until it becomes mandatory to do so.

A survey of our European member firms also showed that while approximately three-quarters of respondents recognised the benefits of IFRS for SMEs generally, there were doubts over the necessity of mandatory IFRS for the smallest SMEs – so-called micro companies with fewer than 10 employees and revenue of less than €2m. Nearly a third of Nexia members said that IFRS for SMEs will not be of use to such micro SMEs in their country.

Paradoxically, it's worth noting that the new version of IFRS defines SMEs as companies that do not have public accountability and publish general purpose financial statements. The key criteria is NOT size, so large private companies with thousands of employees could use IFRS for SMEs, while very small publicly accountable outfits would be required to adopt full IFRS.

Significant challenge

With global economic woes seemingly lightening, many companies may now have more time to focus attention on their accounting. Understanding the differences between IFRS for SMEs and Generally Accepted Accounting Principles in their own countries will be a significant challenge for many companies.

It is important that finance teams consider these issues sooner rather than later, but adoption of IFRS for SMEs may prove to be just as challenging as the development of the new accounting rules was in the first place.

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Capital markets

London calling: why overseas companies join AIM

AIM – London's Alternative Investment Market – continues to attract smaller and medium-sized international companies, with around one-fifth of the close to 1,100 companies listed on it coming from outside the UK.

AIM was launched in 1995 by the London Stock Exchange (LSE) to provide a second-tier alternative for smaller cap public companies and has become a truly international market.

Viable alternative
More flexible entry and maintenance requirements for listed companies make it a viable alternative to the main London market, but there are numerous reasons why an overseas company would want to be listed on AIM in the UK. These include:

- access to international capital
- a market specifically designed to serve mid-market companies
- a springboard into Europe
- simplified rules designed to reduce the administrative burden surrounding corporate transactions
- a simplified mechanism for raising secondary funds.

Analysts believe overseas businesses are likely to continue to play a big part in the future growth of AIM. It is also expected that larger businesses than has traditionally been the case will want to be associated with it. Certain sectors – oil and gas, mining, minerals, renewable energy, technology to name a few – are predicted to remain attractive to investors on AIM in the short to medium term.

Growth potential
AIM's largely institutional investor base comprises many of the international names one would expect of a market that has demonstrated its growth potential – Fidelity, Merrill Lynch, Blackstone and others. If these institutions are investing on AIM then international companies can expect a knowledgeable and enthusiastic audience – and one with significant financial muscle.

AIM's listing requirements, which include the need to appoint and retain a nominated adviser (Nomad) at all times, are less onerous compared to, say, the main market of the LSE. These include:

- no minimum amount of shares to be in public hands
- no trading history requirement
- no prior shareholder approval for corporate transactions (unless they more than double the size of the company)
- no need for admission documents to be pre-vetted by the LSE or the UK Listing Authority (UKLA) in most circumstances. (The UKLA will only vet an AIM admission document where it is also a prospectus under the Prospectus Directive.)
- no minimum market capitalisation.

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Asia Pacific

China growth trend looks set to continue

As we move through the Year of the Rabbit, it is clear that last year's dramatic growth in China's economy is likely to continue this year and in years to come.

Even as the global economic downturn left many countries experiencing questionable recoveries, China's 2010 gross domestic product (GDP) growth topped out at nearly 10% and the country continues to be a magnet for inward investment from around the world. Indeed, it is almost impossible to ignore China's growth and the vast size of its domestic market in global business planning and investment decisions.

Foreign investment
So far this year, from January to April, direct foreign investment value in China is up by around 26% year on year, with 8,152 newly approved, foreign-invested enterprises entering the market. This growth is fuelled not only by strong economic growth but also by the Chinese government's policies to encourage a higher level of domestic consumer spending, its continued policy changes designed to attract foreign investment, and its encouragement of foreign investment in high technology, the environmental arena and even in the financial services sector.

Tax law changes by the State Administration of Taxation (SAT) are coming slowly, as was the case last year, and most efforts are focused on standardising regulations to bring greater consistency from region to region, and to level the playing field for both foreign and domestic companies. SAT also continues to close gaps in laws that have previously caused loss of tax revenues.

Most of the regulatory changes we have seen in the last several months have been clarifications and definitions designed to clarify issues relating to rules that already exist, but which have not been enforced consistently throughout the country.

Challenges
In spite of its impressive GDP growth rate, which should be around 9% this year, China faces significant challenges, notably inflation and a housing market in which prices have risen too rapidly during the last several years.

However, in facing the challenges, the government remains flexible and continues to review and adjust as needed. Indeed, all the signals indicate that China will soon emerge, not only as the largest market in the world, but also as the largest economy.

Foreign investment in China seems not only desirable, but also increasingly necessary for any company with global growth ambitions.

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North Africa

Will 'Jasmine Revolution' lead business evolution

The economy was one of the big causes of the so-called Jasmine Revolution in Tunisia, so what's the future for business now that President Zine al-Abidine Ben Ali and his one-party regime have gone?

Ben Ali's reign saw his relatives and allies prosper, but many ordinary Tunisian folk struggled to find work or pay for food – a situation worsened by the world recession. Ben Ali quit on 14 January, to be replaced by a new national unity government that has ushered in freedom of the press and promises further moves towards democracy with elections on 24 July this year.

Retrospective audits

The business environment in the country is obviously very fluid and there's concern about the extent of the business empires owned or run by Ben Ali supporters. The new government has said that it will require retrospective audits of all companies owned directly or indirectly by the former president's family and relatives.

Such audit requirements will also apply to all significant public procurement of services provided by publicly owned companies or institutions.

With Transparency International estimating Ben Ali and his relatives controlled between 20% and 30% of the Tunisian economy, this should make for interesting and busy times ahead for the country's chartered accountants.

Many international financial institutions, including the European Investment Bank (EIB), African Development Bank (AfDB) and the International Monetary Fund, have offered Tunisia significant financial support aimed at infrastructure and regional development projects.

The EIB is expected to grant assistance totalling €258m ($348m) during 2011-13 and another €1bn could be in the pipeline.

The AfDB has also committed to work with the Tunisian government towards the country's recovery and smooth transition. The bank has pledged to see through infrastructure and regional development business projects with which it was involved in the country.

Also, many non-profit organisations have declared their willingness to fund projects now that financial arrangements are likely to be more transparent than under the old regime.

Upbeat

Tunisians are upbeat about a business environment that will once again include the Tunis Bourse Stock Exchange, which reopened in February.

And calm on the streets will help the tourists return – the sector contributes 6.5% to gross domestic product and employs about 350,000 Tunisians.

All in all, there are plenty of reasons for cautious optimism among Tunisia's business community.

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Inward investment

Privatisation auctions are great chance to buy into Polish companies

Investors looking to Poland's booming economy should take note of the country's privatisation auctions.

The Polish government's programme of privatisation has been an important tool in the country's rapid development and reconstruction since the beginning of political and economic transformation in 1990. Successful privatisations in many industry sectors have given foreign investors access to the Polish consumer and manufacturing markets.

Successes

Encouraged by such successes, the Polish government is mid-way through a programme to privatise 802 companies by the end of 2011. The treasury auctions represent an efficient, fast and potentially attractive way to acquire financially stable Polish small and medium-sized enterprises (SMEs). Acquiring these formerly state-owned businesses also provides a potential platform to access Poland's growing and well-structured capital market.

Public auctions are just one method of sale. They are used mostly for SMEs when the treasury decides its primary goal is not so much facilitating foreign capital supply but ensuring a good sale price. So, investors looking to buy a controlling interest in companies operating in Poland's booming economy should pay close attention to the auctions.

The window of opportunity to acquire state-owned SMEs that have been put up for sale by the Polish treasury closes at the end of 2011. More than 500 companies remain to be sold. Companies on offer come from a number of different industry sectors, including energy and natural resources, transport, defence and financial institutions.

Thriving Polish economy

Poland is the sixth-largest country in the European Union (EU) and is steadily reducing the gross domestic product (GDP) gap separating it from the 15 'old' EU countries. According to European Commission forecasts (published July 2010), Poland's GDP growth will reach 3.3% in 2011, making it the fastest-developing country in the EU.

With the Polish economy thriving, a stable and hard working middle class is ready to put its cash into the Warsaw Stock Exchange (WSE) and its recently launched alternative market, NewConnect. The result is a WSE that is increasingly attractive to foreign-origin firms doing business in Poland and across Central and Eastern Europe.

The flow of fresh capital to large companies and newcomers alike is one of the major factors in the recent Polish economic boom. This has meant diversity of risk and promoted a real, rather than virtual, economy of manufacturing, instead of the focus on financial services favoured by many other countries.

Nevertheless, banking is a sector also widely expected to drive economic prosperity, along with property, services, wholesale and EU-financed infrastructure projects.

Privatisation auction news is available from the Polish treasury, but prospective foreign investors should get local, on-the-ground guidance about the processes involved.

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Taxation

VAT needs international rules of the game

Imagine the next football World Cup with each of the qualifying national teams playing to slightly different rules. Imagine the rows. This is not far from the reality of global indirect taxes, with companies struggling to understand what they should be paying and to whom.

The Organisation for Economic Co-operation and Development (OECD) is calling for the world to learn from the European Union (EU) experience of value-added tax (VAT) 'standardisation' and adopt global principles. This might not be the 'beautiful game', but it might mean fewer of the international arguments much loved by tax lawyers and clearer rules for all.

Many tax advisers will tell you that VAT is an EU tax, so the principles involved are the same in each of the 27 member states. The reality is very different: the operation and administration of VAT on a day-to-day basis differ widely between member states.

Convergence

Only as a result of the economic downturn have we seen some convergence of standard rates around the EU. That's because as a self-assessed turnover tax, with businesses used as unpaid tax gatherers, every extra penny or euro of VAT raised goes straight to the national treasury's bottom line.

An EU Business Expert Group is to report on VAT differences with the aim of helping to establish a single set of EU-wide rules. There have already been moves to adopt an EU-wide approach to the VAT treatment of supplies; the most recent example being the introduction of the VAT Package from January 2010, whereby services are deemed to be supplied where the client belongs.

One of the objectives is to create more certainty as to whether the supplier or the customer should account for VAT. There have been numerous cases where member states have argued either the right to tax, or not to tax, on cross-border transactions.

Beyond the EU

VAT in some form can be found in almost every developed country in the world. So, should we not be thinking of place-of-supply rules in terms of global trade activities?

The OECD's Committee on Fiscal Affairs has invited comment on draft international guidelines that deal with the client country of 'belonging' in order to fix the jurisdiction for tax.

It has been suggested that such guidelines should be without any legislative force. But why should these rules not be incorporated into Double Tax Treaties (DTTs) between countries operating turnover-based taxes?

For direct tax purposes there already exists a well-developed and understood body of DTTs that deal with taxing rights and the treatment of a range of income streams. Would it not make sense to extend these treaties in order to deal with VAT, and specifically introduce place-of-supply rules with tie-breaker clauses to provide certainty on indirect taxing rights?

In this way, it should be possible to avoid the long-running tax disputes seen in the EU in the past. Now is the time for action.

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Taxation

Nexia updates definitive guide to international tax

Nexia International has published a new edition of its indispensable, one-stop global tax guide.

The International Tax Handbook, 3rd edition provides a concise overview of the tax systems in more than 90 countries.

Published by Bloomsbury Professional, each chapter covers a single country and includes information on legal forms, corporate tax, personal tax, withholding taxes and indirect taxes.

Accessible
It's an accessible and user-friendly first point of reference for businesses, advisers, policy-makers and investors looking at opportunities overseas, plus anyone considering living or working abroad.

"The handbook has proved very popular with finance directors who need key tax information when considering cross-border activity," says editor Rajesh Sharma, a director of Nexia member firm Smith & Williamson and chairman of Nexia's International Tax Committee, who specialises in advising clients on international tax.

"We've brought together in a single source all the relevant tax information needed to make informed enquiries when considering cross-border activities," says Rajesh, who nonetheless stresses the importance of obtaining local advice on tax matters.

Written in accessible language aimed at non-tax specialists, the handbook provides tax information in a format that is easy to access. Readers can quickly find the information they need on a specific country and compare the various tax systems. It will also assist other professional advisers to help discuss broad overseas tax requirements with their clients and direct them to the relevant tax specialists where necessary.

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