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DISCLOSURE PRACTICES IN THE AUTOMOBILE INDUSTRY: A COMPARATIVE ANALYSIS BETWEEN INDIA AND GERMANY

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Abstract

This paper attempts to understand the prevalent accounting disclosures in India and Germany, through a study of the Automobile sector in the two countries. This sector has been picked up because it is massive, competitive, and it is expected to undergo major restructuring in the near future due to globalization and decreasing oil reserves.

To analyse accounting standards in the two countries, the researchers have chosen the time period 2009-11, when two different standards were being used in the two countries: India was employing the standards prescribed by ICAI, while firms in Germany had more or less adapted themselves to IFRS since 2005.

For each country, the study has closely studied the 'Disclosures' in the Financial Statements in each company's Annual Report. The companies that we chose are Daimler Group, Volkswagen Group, and BMW (Bayerische Motoren Werke) Group in Germany, and Mahindra and Mahindra Ltd., Ashok Leyland Ltd., and Tata Motors Ltd. in India.

This analysis of individual firms' financial statements gives a picture of disclosure practices followed in the industry, in the two countries under study. The paper then juxtaposed this analysis with the accounting standards employed in each country, and understood standards based on this analysis. Thus, the paper has been able to pinpoint specific differences in accounting policy as per the two standards, and also recognised the need for simplification. The findings suggest that there are more similarities in the accounting standards as applicable to the automobile sector in India and Germany. However the quality and content of the disclosures of German Automobile firms is superior to Indian counterparts.

INTRODUCTION

Diversity across industries and companies imply a corresponding variety in accounting practices and choices, across different countries and economic regions. The world is now moving towards adapting a set of standards referred to as International Financial Reporting Standards (IFRS). These standards are a brainchild of the International Accounting Standards Board (IASB), and were developed with the objective to simplify accounting norms and their disclosure, and bring about greater investor confidence. As per Matthew (2006) one also needs to distinguish between claimed accountability from practiced accountability.

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RESEARCH METHODOLOGY

This paper attempts to understand the prevalent accounting disclosures in India and Germany, through a study of the Automobile sector in the two countries.

This sector has been picked up because it is massive, competitive, and it is expected to undergo major restructuring in the near future due to globalization and decreasing oil reserves.

To analyse accounting standards in the two countries, we have chosen the time period 2009-11, when two different standards were being used in the two countries: India was employing the standards prescribed by ICAI, while firms in Germany had more or less adapted themselves to IFRS.

For each country, we have closely studied the 'Disclosures' in the Financial Statements in each company's Annual Report. The companies that we chose are Daimler Group, Volkswagen Group, and BMW (Bayerische Motoren Werke) Group in Germany, and Mahindra and Mahindra Ltd., Ashok Leyland Ltd., and Tata Motors Ltd. in India.

This analysis of individual firms' financial statements gave us a picture of disclosure practices followed in the industry, in the two countries under study. As per Wanda (1992) there can be a power struggle between the management and the auditor with regard to disclosures. We have then juxtaposed this analysis with the accounting standards employed in each country, and understood these standards based on this analysis. Thus, we have been able to pinpoint specific differences in accounting policy as per the two standards, and also recognised the need for simplification.

THE AUTOMOBILE SECTOR IN INDIA AND GERMANY

Today, driving the most luxurious car has been made possible by the stiff competition in the automobile industry around the world, with overseas players in India specifically gathering the same momentum as the domestic participants.

Germany is supposed to be the birthplace of the automobile. The automobile industry in Germany is one of the largest employers in the country, with a strong labour force of over 866,000 working in the industry. In addition, Germany has the largest share of passenger car production in Europe with over 29% market share (source: OICA, 2002), followed by France (18%), Spain (13%) and the United Kingdom (9%).

Currently, six German companies dominate the automotive industry in the country: Volkswagen AG, BMW AG, Daimler AG, F. Porsche AG, Adam Opel AG and Ford-Werke GmbH. Nearly six million vehicles are produced in Germany each year, and approximately 5.5 million are produced overseas by German brands. Alongside the United States, China and Japan, Germany is one of the top 4 automobile manufacturers in the world. The Volkswagen Group is one of the three biggest automotive companies of the world (along with Toyota and General Motors).

India and Germany are targetting Euro 20 billion trade by 2011.

The automobile industry in India happens to be the ninth largest in the world. Following Japan, South Korea and Thailand, in 2009, India emerged as the fourth largest exporter of automobiles. Several Indian automobile manufacturers have spread their operations globally as well, asking for more investments in the Indian automobile sector by the MNCs.

In 2009, the automobile industry in India saw a growth rate of around 9%, keeping in mind that the auto industry in India was hit badly by the ongoing global financial crisis at that time. The market share of various segments in the automobile industry in India in 2009 has been depicted alongside.

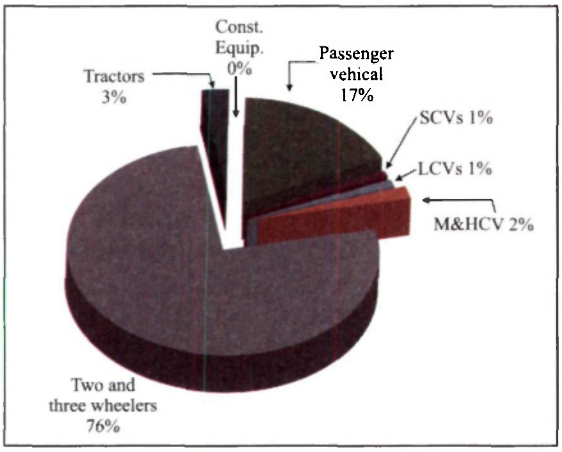

Figure 1: Market Share 2009

COMPARATIVE ANALYSIS

Accounting Policies refer to specific accounting principles and the method adopted by enterprises in applying these principles in the preparation and presentation of the financial statements. In our comparison between India and Germany, we have analysed significant disclosures of accounting policies in the two countries, based on the following broad heads:

(a) Methods of depreciation, depletion and amortization

(b) Treatment of expenditure during construction

(c) Conversion or translation of foreign currency items

(d) Valuation of inventories

(e) Treatment of goodwill

(f) Valuation of investments

(g) Treatment of retirement benefits

(h) Recognition of profit on long-term contracts

(I) Valuation of fixed assets

(j) Treatment of contingent liabilities

The comparative analysis has been presented below:

INDIA	GERMANY
1. BASIS OF PRESENTATION	
The financial statements are prepared in accordance with the generally accepted accounting principles (GAAP) in India and comply with the Accounting Standards notified under sub-section (3C) of Section 211 of the Companies Act, 1956 and the relevant provisions thereof	The financial statements in Germany have been prepared in accordance with Section 315a of the German Commercial Code (HGB) and International Financial Reporting Standards , as applicable. In particular, the Volkswagen Group has also shared the unit of currency employed, a detailed representation of the effect of each IFRS standard on their accounting figures, which means a much better quality disclosure.
2. VALUATION OF FIXED ASSETS	
Fixed assets are stated at cost of acquisition or construction less accumulated depreciation. At Tata Motors, for instance, the cost of an asset includes purchase price, taxes and duties, labour cost and directly attributable costs for self-constructed assets and other direct costs incurred up to the date the asset is ready for its intended use.	The German companies have classified fixed assets into further heads of – a) property, plant and equipment, b) equipment on operating leases, c) investments accounted for using the equity method, d) receivables from financial services, e) marketable debt securities, and f) other financial assets. Most of these are accounted for under the historical cost convention, in the Volkswagen Group.
3. METHODS OF DEPRECIATION, DEPLETION AND AMORTISATION	
At Mahindra and Mahindra, leasehold land is amortised over the period of the lease. At Ashok Leyland amortises a deferred expenditure over the unexpired period or sixty months, whichever is lesser. In India, depreciation on assets is calculated on Straight Line Method at the rates and in the manner prescribed in Schedule XIV to the Companies Act, 1956.	In Germany too, assets are depreciated using the straight-line method over their estimated useful lives or over the lease period, if shorter.

INDIA	GERMANY
4. VALUATION OF INTANGIBLE ASSETS	
In India, Intangible Assets are initially measured at cost and amortised so as to reflect the pattern in which the asset's economic benefits are consumed. At Mahindra and Mahindra, intangible assets are classified into three groups: technical know-how, development expenditure and software expenditure.	Purchased and internally-generated intangible assets are recognized as assets in accordance with IAS 38 (Intangible Assets), where it is probable that the use of the asset will generate future economic benefits and where the costs of the asset can be determined reliably. At BMW Group, such assets are measured at acquisition and /or manufacturing cost and, to the extent that they have a finite useful life, amortized (or depreciated) on a straight-line basis over their estimated useful lives.
5. EARNINGS/ LOSS PER SHARE	
In Germany, earnings per share are computed based on the IAS 33. This calculation is done for common and preferred stock by dividing the net profit after minority interests, as attributable to each category of stock, by the average number of outstanding shares. Then, net profit is accordingly allocated to the different categories of stocks. Rest of the net profit for the year which is not being distributed is allocated to each category of stock based on the number of outstanding shares.	In India, earnings per share are computed by dividing company's profit after taxation as per Profit and Loss account from weighted average number of outstanding equity shares. These practices are disclosed in notes section of annual report of the company. Please find a detailed diagrammatic representation below.

INDIA'S TREATMENT OF EARNINGS PER SHARE	2011	2010
Basic earnings per share		
Profit after taxation as per Profit and Loss account (in Rs. lakhs) (A)	63129.93	42367.48
Weighted average number of equity shares outstanding (B)	1330338317	1330338317
Basic earnings per share (Face value Re. 1) (in Rs.) (A/B)	4.75	3.18

6. REVENUE RECOGNITION	
The standard explains as to when the revenue should be recognized in profit and loss account and also states the circumstances in which revenue recognition can be postponed. Revenue means gross inflow of cash, receivable or other consideration arising in the course of ordinary activities of an enterprise such as the sale of goods, rendering of services, and use of enterprises resources by other yielding interest, dividend and royalties. In	Revenue from sales of vehicles, service parts and other related products is recognized when the risks and rewards of ownership of the goods are transferred to the customer, the amount of revenue can be estimated reliably and collectability is reasonably assured. Revenue is recognized net of sales reductions such as cash discounts and sales incentives granted. Daimler uses sales incentives in response to a

6. REVENUE RECOGNITION	
other words, revenue is a charge made to customers / clients for goods supplied and services rendered. For Mahindra, Sales of products and services are recognised when the products are shipped or services rendered including export benefits thereon. Dividend from investments is recognised in the Profit and Loss Account when the right to receive payment is established.	number of market and product factors, including pricing actions and incentives offered by competitors, the amount of excess industry production capacity, the intensity of market competition and consumer demand for the product.
7. TAXES ON INCOME	
Income tax expenses comprise current and deferred taxes. Current tax is the amount of tax payable on the taxable income for the year as determined in accordance with the provisions of the Income Tax Act, 1961. Current tax is net of credit for entitlement for Minimum Alternative tax. Deferred tax is recognised, on timing differences, being the difference between taxable income and accounting income that originate in one period and are capable of reversal in one or more subsequent periods. Deferred tax assets in respect of unabsorbed depreciation and carry forward of losses are recognised if there is virtual certainty that there will be sufficient future taxable income available to realise such losses. Deferred tax assets and liabilities are measured based on the tax rates that are expected to apply in the period when asset is realised or the liability is settled, based on tax rates and tax laws that have been enacted or substantially enacted by the balance sheet date.	Current income taxes are determined based on the respective local taxable income of the period and local tax rules. In addition, current income taxes include adjustments for uncertain tax payments or tax refunds for periods not yet assessed as well as interest expense and penalties on the underpayment of taxes. Deferred taxes are included in income taxes and reflect changes in deferred tax assets and liabilities except for changes recognized directly in equity. Deferred tax assets or liabilities are determined based on temporary differences between financial reporting and the tax basis of assets and liabilities including differences from consolidation, loss carry forwards and tax credits. Measurement is based on the tax rates expected to be effective in the period in which an asset is realized or a liability is settled. For this purpose, the tax rates and tax rules are used which have been enacted or substantively enacted at the reporting date. Deferred tax assets are recognized to the extent that taxable profit at the level of the relevant tax authority will be available for the utilization of the deductible temporary differences. Daimler recognizes a valuation allowance for deferred tax assets when it is unlikely that a corresponding amount of future taxable profit will be available or when Daimler no longer has control over the tax advantage.
8. TREATMENT OF INVENTORIES	
Inventories comprise all costs of purchase, conversion and other costs incurred in bringing the inventories to their present location and condition. Raw materials and bought out	Inventories are measured at the lower of cost and net realizable value. The net realizable value is the estimated selling price less any remaining costs to sell. The cost of inventories

8. TREATMENT OF INVENTORIES	
components are valued at the lower of cost or net realisable value. Cost is determined on the basis of the weighted average method. Finished goods produced and purchased for sale, manufactured components and work in progress are carried at cost or net realisable value whichever is lower. Excise duty is included in the value of finished goods inventory. Stores, spares and tools other than obsolete and slow moving items are carried at cost. Obsolete and slow moving items are valued at cost or estimated realisable value, whichever is lower. Long term contracts in progress are valued at cost.	is based on the average cost principle and includes costs incurred in acquiring the inventories and bringing them to their existing location and condition. In the case of manufactured inventories and work in progress, cost also includes production overheads based on normal capacity.
9. BORROWING COSTS	
Enterprises are borrowing the funds to acquire, build and install the fixed assets and other assets, these assets take time to make them useable or saleable, therefore the enterprises incur the interest (cost of borrowing) to acquire and build these assets. The objective of the Accounting Standard is to prescribe the treatment of borrowing cost (interest + other cost) in accounting, whether the cost of borrowing should be included in the cost of assets or not. In Mahindra, all borrowing costs are charged to the Profit and Loss Account except: Borrowing costs that are attributable to the acquisition or construction of assets that necessarily take a substantial period of time to get ready for their intended use, which are capitalised as part of the cost of such assets. Expenses incurred on raising long term borrowings are amortised over the period of borrowings. On early buyback, conversion or repayment of borrowings, any unamortised expenditure is fully written off in that year.	As a general rule, borrowing costs are not included in acquisition or manufacturing cost. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are recognized as a part of the cost of that asset in accordance with IAS 23 (Borrowing Costs). Borrowing costs are expensed as incurred unless they are directly attributable to the acquisition, construction or production of a qualifying asset and therefore are part of the cost of that asset. As a general rule, borrowing costs are not included in acquisition or manufacturing cost. Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are recognized as a part of the cost of that asset in accordance with IAS 23 (Borrowing Costs). Borrowing costs are expensed as incurred unless they are directly attributable to the acquisition, construction or production of a qualifying asset and therefore are part of the cost of that asset.
10. IMPAIRMENT OF ASSETS	
The dictionary meaning of 'impairment of asset' is weakening in value of asset. In other words when the value of asset decreases, it may be called impairment of an asset. As per AS-28 asset is said to be impaired when carrying amount of asset is more than its recoverable amount.	Impairment losses on receivables relating to financial services business are recognised using a uniform methodology that is applied throughout the Group and meets the requirements of IAS 39. This methodology results in the recognition of impairment losses on individual assets and groups of assets.

10. IMPAIRMENT OF ASSETS	
In Tata Motors, at each balance sheet date, the Company assesses whether there is any indication that the fixed assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment, if any. Where it is not possible to estimate the recoverable amount of individual asset, the Company estimates the recoverable amount of the cash-generating unit to which the asset belongs. As per the assessment conducted by the Company at March 31, 2011, there were no indications that the fixed assets have suffered an impairment loss.	If there is objective evidence of impairment, the BMW Group recognises impairment losses on the basis of individual assets. The recognition of impairment losses on receivables relating to industrial business is also, as far as possible, based on the same process applied to financial services business. Impairment losses (write-downs and allowances) on receivables are always recorded on separate accounts and de-recognised at the same time the corresponding receivables are de-recognised.

11. ACCOUNTING FOR LEASES	
Lease is an arrangement by which the lesser gives the right to use an asset for given period of time to the lessee on rent. It involves two parties, a lessor and a lessee and an asset which is to be leased. The lessor who owns the asset agrees to allow the lessee to use it for a specified period of time in return of periodic rent payments. Mahindra's significant leasing arrangements are in respect of operating leases for premises (residential, office, stores, godowns, computer hardware etc.). The leasing arrangements, which are not non-cancellable, range between eleven months and five years generally, and are usually renewable by mutual consent on agreed terms. The aggregate lease rentals payable are charged as rent.	Leasing includes all arrangements that transfer the right to use a specified asset for a stated period of time in return for a payment, even if the right to use such asset is not explicitly described in an arrangement. The Group is a lessee of property, plant and equipment and a lessor of its products. It is evaluated on the basis of the risks and rewards of a leased asset whether the ownership of the leased asset is attributed to the lessee (finance lease) or to the lessor (operating lease). Rent expense on operating leases where the Group is lessee is recognized over the respective lease terms on a straight-line basis. Equipment on operating leases where the Group is lessor is carried initially at its acquisition or manufacturing cost and is depreciated to its expected residual value over the contractual term of the lease, on a straight-line basis. The same accounting principles apply to assets if Daimler sells such assets and leases them back from the buyer.

CONCLUSION

There are more similarities in the accounting standards as applicable to the automobile sector in India and Germany. However the quality and content of the disclosures of German Automobile firms is superior to Indian counterparts.

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