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MULTINATIONAL ENTERPRISES AND DISCLOSURE OF INFORMATION

C L A R I F I C A T I O N

of the OECD Guidelines

89-1513

MULTINATIONAL ENTERPRISES AND DISCLOSURE OF INFORMATION

CLARIFICATION OF THE OECD GUIDELINES

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

Pursuant to article 1 of the Convention signed in Paris on 14th December, 1960, and which came into force on 30th September, 1961, the Organisation for Economic Co-operation and Development (OECD) shall promote policies designed:

- to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries, while maintaining financial stability, and thus to contribute to the development of the world economy;
- to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development; and
- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

The original Member countries of the OECD are Austria, Belgium, Canada, Denmark, France, the Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States. The following countries acceded subsequently through accession at the dates hereafter: Japan (28th April, 1964), Finland (28th January, 1969), Australia (7th June, 1971) and New Zealand (29th May, 1973).

The Socialist Federal Republic of Yugoslavia takes part in some of the work of the OECD (agreement of 28th October, 1961).

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The Guidelines for Multinational Enterprises have been adopted by the OECD Member governments in 1976. They represent collective expectations of governments concerning the behaviour and activities of multinational enterprises. They set out, in the chapter on disclosure of information, a list of items to be covered in published financial reports (see Annex at the end of this book). It has been felt necessary to clarify the accounting terms used in order to increase awareness and application of the Guidelines.

The clarifications set out in the present report are the result of intensive studies by the Working Group on Accounting Standards of the Committee on International Investment and Multinational Enterprises. A first set of clarifications was published in 1983. These clarifications have now been updated and completed to include specific aspects of accounting and reporting by banks and insurance companies.

They have been prepared in consultation with the international business community, trade unions and the accounting profession represented respectively through the Business and Industry Advisory Committee to the OECD (BIAC), the Trade Union Advisory Committee to the OECD (TUAC), the International Accounting Standards Committee (IASC) and the Fédération des experts-comptables européens (FEE).

The document was adopted by the Committee on International Investment and Multinational Enterprises and the OECD Council agreed to its derestriction on 14th March 1988.

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I. INTRODUCTION

Disclosure of information so as to give greater transparency to the activities of multinational enterprises through publication of a volume of information "presented in a form designed to improve public understanding" is a key element of the OECD Guidelines for Multinational Enterprises. To that end, a list of items which are recommended to be covered in the published reports of multinational enterprises was furnished in the chapter on disclosure of information of the Guidelines. It was hoped that, in this way, the general level of disclosure of information by enterprises should be improved by supplementing, where necessary, the disclosure requirements embodied in national laws and practices. Where national law and practice were less comprehensive, it was nevertheless intended that enterprises should take action under the Guidelines by publishing voluntarily the information called for.

Experience has shown that a number of accounting terms and disclosure items in the chapter on disclosure of information required further explanation to assist enterprises in complying with them. Considering also the lack of harmonization of basic accounting standards in the OECD area, the Committee on International Investment and Multinational Enterprises – the body responsible within the OECD to follow the application of the Guidelines – established a Working Group on Accounting Standards with two main tasks: to develop clarifications of the accounting terms contained in the chapter on disclosure of information of the OECD Guidelines, and to promote efforts towards increased comparability of financial information and harmonization of accounting standards.

In 1983 a first set of clarifications was published covering most of the items included in the chapter on disclosure of information of the Guidelines, i.e. operating results, sales, new capital investment, sources and uses of funds, average number of employees, research and development expenditure, accounting policies and segmentation of information. As a result of the work carried out since 1983, the present report presents a substantially revised and expanded version of this publication. The clarifications set forth now cover all items of the chapter on disclosure of information and specific clarifications are provided referring to the special characteristics of banks and insurance companies.

Since its inception in 1979, the Working Group on Accounting Standards has considered that it should work in close co-operation with those directly concerned with the quality and quantity of information published by enterprises. The international business community and the employees represented respectively by the two OECD consultative bodies – Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) – and the accounting profession through the International Accounting Standards Committee (IASC) and the EEC Groupe d'Etudes des Experts Comptables[1] have been associated with its work through informal consultations. The clarifications set forth in this document are the result of intensive studies including surveys of actual practices in OECD countries, the analysis of the problems that were identified and the search for common elements. They are being published as a contribution to the efforts being made at national and international levels to improve the quantity, quality and comparability of published information on the activities of enterprises.

The clarifications that are being issued do not modify the Guidelines. Their purpose is to explain in more detail the meaning of the existing provisions in order to provide guidance to the parties concerned when preparing and using published accounts of enterprises and to assist enterprises in their understanding and application of the Guidelines. Each of the clarifications provided in this report, to be understood correctly, should be read in conjunction with the explanations and the analysis on which they are based.

Parallel to the development of the clarifications, the Working Group has been pursuing its general task to encourage greater comparability and harmonization of accounting and reporting throughout the OECD area. To this end, the Working Group has based its action on the following principles:

- Holding regular exchanges of information and views on current national and international developments in the accounting field;
- Identifying the main problem areas for comparability and harmonization of accounting concepts;
- Bringing such problems to the attention of national and international standard-setting bodies, for instance, by means of informal meetings;
- Considering what further efforts could help to maintain the momentum of the harmonization process.

In this context, the Working Group is examining institutional obstacles to the process of harmonization of accounting standards as well as problems of a substantive nature where differences in national practices are of particular importance for reporting by multinational enterprises and the effective operation of the Guidelines.

In 1985 the Working Group organised a Forum on International Harmonization of Accounting Standards bringing together, for the first time at international level, representatives of all groups concerned with accounting standard-setting – government officials, representatives of national and international standard-setting bodies, intergovernmental organisations, representatives of business, trade unions and other users of financial statements and the accounting profession[2]. Subsequent informal meetings of the Working Group dealt with specific topics of accounting standards harmonization and a number of technical studies prepared by subgroups composed of government delegates and representatives of BIAC, TUAC, IASC and the European Federation of Accountants (FEE) have been published[3]. It is hoped that these activities, together with the clarifications that have been provided will further the ultimate objective of the chapter on disclosure of information of the Guidelines to improve public understanding "of the structure, activities and policies of the enterprise as a whole".

II. GENERAL CLARIFICATIONS

A. STRUCTURE OF THE ENTERPRISE

Rationale for disclosure

As stated in the introductory chapter of the Guidelines, the complexity of multinational enterprises sometimes gives rise to concern. Therefore disclosure of information so as to give greater transparency to the structure, activities and policies of the enterprise as a whole is a key element of the Guidelines. In order to understand the structure of a multinational enterprise the reader of financial reports needs to have an overview of the linkages between the component entities of the enterprise as a whole.

Issues for clarification

Rather than seeking to define the terms "parent company" and "affiliates" which have a different meaning in various legal systems, the clarification of the "structure of the enterprise" addresses itself to two basic questions:

- Who should provide the information?
- What should be the substance of the information provided?

In clarifying what is meant by "structure of the enterprise" in item *i)* of the disclosure of information chapter of the Guidelines it is important to bear in mind the general description of a multinational enterprise set out in paragraph 8 of the introductory chapter. These enterprises "usually comprise companies or entities whose ownership is private, state or mixed, established in different countries and so linked that one or more of them may be able to exercise a significant influence over the activities of others and, in particular, to share knowledge and resources with others". The Guidelines are addressed "to the various entities within the multinational enterprise (parent companies and/or local entities) according to the actual distribution of responsibilities among them on the understanding that they will co-operate and provide assistance to one another as necessary to facilitate observance of the Guidelines".

The criteria set out in paragraph 8 of the introduction to the Guidelines cover a broad range of structural patterns of multinational activities. As the disclosure of information chapter of the Guidelines concerns the enterprise as a whole, information on the structure of the enterprise would be expected to be provided at the highest level of which financial statements for the enterprise as a whole are produced. Concerning the contents of the information to be disclosed, it is the purpose of the Guidelines to provide an economic picture of the enterprise as a whole.

Item *i)* of the chapter on disclosure of information of the Guidelines does not call for disclosure of detailed organisational patterns and the distribution of managerial activities within the enterprise as a whole. Such information may be relevant to specific user groups, e.g. employees, and could be a matter for special purpose reports rather than published financial statements.

Apart from the general consideration that the information should be published in a form suited to improve public understanding, the Guidelines do not recommend any specific modality for disclosing the structure of the enterprise. There are various alternatives which can be used for that purpose, e.g. inclusion in the directors' report, in the notes to the financial statements, diagrams.

Information on the structure of the enterprise is closely linked to the indication called for in item *ii)* of the disclosure of information chapter of the Guidelines regarding "the geographical areas where operations are carried out and the principal activities carried on therein by the parent company and the main affiliates". As a definition of what is meant by geographical areas is provided as a footnote in the text of the Guidelines themselves, there is no need for additional clarification under this item.

Conclusions

In light of the foregoing considerations, the following clarification of item *i)* of the chapter on disclosure of information is given:

> **"The composition of the enterprise as a whole should be described and disclosure made to provide an overview of the linkages between its various entities. This information should be provided with consolidated financial statements or, where these are not issued, by other means e.g. with individual statements of the entity or entities representing the enterprise as a whole."**

B. SALES

Rationale for disclosure under this item

Disclosure of sales provides an indication of the level and trend of business of the enterprise, and hence of its economic and social importance, and permits comparison of the relationship of various other elements from the enterprise's financial statements with sales and enables an enterprise's position in the market place to be established. This information can be used for inter-enterprise comparisons and for following the trend of operations for a chosen enterprise.

Issues for clarification

The main areas for consideration in reaching a common understanding of sales arise from the treatment of:

- Sales rebates;
- Turnover taxes;
- Revenue from extraordinary activities.

i) Sales rebates

Sales rebates represent genuine reductions of sales and therefore form an integral part thereof. Consequently they should be deducted when disclosing sales. On the other hand, discounts for prompt payment are of a different nature and represent part of an enterprise's financing policy and should not therefore be deducted from sales for the purposes of disclosure.

ii) Turnover taxes

Turnover taxes and sales taxes are imposed on enterprises as a part of the fiscal policy of Member countries. The inclusion of such taxes in sales can distort the true picture of the economic activity of an enterprise and can render comparison of the level of sales of enterprises in different countries with different tax rates difficult, if not impossible. Because of the impact of sales not subject to turnover tax (exports, for example) it would generally not be possible for the reader of financial statements to make his own adjustment to eliminate turnover taxes where included, for the purpose of comparison with enterprises where such taxes were excluded. Accordingly, are excluded turnover and sales taxes and other taxes directly related to turnover from sales as defined.

iii) Revenue from extraordinary/unusual activities

It is agreed that revenues from extraordinary/ unusual activities should not be grouped with revenues from ordinary activities. The term "sales" therefore should refer only to ordinary activities.

Conclusions

In the light of the foregoing considerations, the following clarification of the item "sales" is given:

"Amounts derived from the sale of products and provision of services falling within the enterprise's ordinary activities after deduction of sales rebates, value-added taxes and other taxes directly linked to turnover."

C. OPERATING RESULTS

Although the term "operating results" is widely used and embodied in international recommendations on disclosure of information, there is no generally accepted definition of the elements to be embodied therein. In Member countries the concept of operating results is usually understood as referring to income from normal trading activities before interest and taxes. In some countries, the term "operating results" generally includes all revenues, cost and expenses (including interest and income taxes) of the enterprise entering into the determination of income. However, several countries and the EEC Directives do not specifically refer to the concept "operating results" but require component elements to be disclosed from which operating revenues minus operating expenses can be calculated.

The term "operating results" is specifically mentioned only in connection with segmentation by geographic area. In that context, the term tends to be restricted in scope because of the difficulties in sensibly allocating certain common items. In the allocation of common cost, comparability is best served by limiting allocated amounts to those which are susceptible to clear and rational allocation criteria. Items such as interest expense and income taxes often cannot be allocated other than arbitrarily and would normally be excluded from disclosure of operating results on a geographic or other segmented basis. However before considering any restrictions to the term "operating results" it is essential to clarify the normal meaning of the term as it applies to the financial statement of the enterprise.

For the purpose of the Guidelines, a common definition of "operating results" is, in itself, not of vital importance. A principal purpose of financial statements is to provide users with the means of assessing a company's performance and financial position. In the context of the profit and loss account this will require disclosure not only of the elements comprising the results of trading but also of all other elements and of unusual items, non-disclosure of which would impair full appreciation and understanding of the company's activities and comparison of figures from year to year and with other companies. The prime need, therefore, would seem to be for proper disclosure of all significant constituent items of income, expense, gain and loss. In this context the following elements call for clarification:

- Extraordinary/unusual items;
- Financial income and expense;
- Prior year items;
- Income tax;
- Depreciation;
- Foreign currency translation

In discussing the issues involved, the Working Group has focused on the accounting problems relating to disclosure under each item, leaving aside questions of measurement which are considered separately in the framework of the Working Group's general mandate to promote comparability and harmonization of accounting standards[4].

In addition to the elements mentioned in the preceding paragraph, the choice of the principles of valuation is of great importance because the amounts involved tend to be significant and because the different methods of valuation available can produce widely differing results. Therefore the disclosure of valuation methods is critical to permit effective comparison of the performance of an enterprise from year to year and between different enterprises. As this matter is covered by the scope of "accounting policies" as defined under section I below, no separate clarification on the disclosure of valuation methods is needed in the context of "operating results".

1. Extraordinary/unusual items

Rationale for disclosure under this item

Elements of income or expense which are unrelated to the entities' normal activities or which distort significantly the results of an enterprise should be separately disclosed to enable the user of the financial statements better to assess the enterprise's performance.

Issues for clarification

Two main issues arise:

- The need to disclose separately items which may distort the presentation of annual results;
- The need for a common understanding of such items so as to ensure consistency of disclosure.

The Working Group, in view of the differences in the practice of Member countries, did not seek uniformity of terminology. The description of the items in question should be left to national practice, as long as this description draws the reader's attention to the unusual character of the items.

In this respect, existing definitions show some common elements. Items that could be qualified as extraordinary/unusual are generally understood to refer to material items deriving from outside the normal activities of a business entity. In addition, it would be useful to disclose material items of an exceptional nature concerning, for instance, their size or frequency deriving from the ordinary activities of the enterprise.

Conclusions

In the light of the foregoing considerations, the following clarification is given:

"Extraordinary/unusual items should be separately disclosed in the income statement or in a note to the financial statements which would indicate the nature and amount of each such material item.

Extraordinary/unusual items will include material items deriving from outside the ordinary activities of an enterprise.

It would also be useful to disclose material items of income or charges deriving from the ordinary activities of an enterprise which are of exceptional nature because of their size or frequency of occurrence."

2. Financial income and expense

Rationale for disclosure under this item

Financial income and expense can be influenced by factors not associated directly with an enterprise's principal activities. Elements such as capital gearing, leasing or buying, acquisition of assets, etc., could all affect inter-enterprise and inter-period comparisons. In order to enable the user of financial statements to assess an enterprise's performance in relation to its financial management separate disclosure of financial income and expense is necessary.

Issues for clarification

It is generally accepted that interest income and expense should be separately disclosed. In accordance with current practice in most Member countries, the setting-off of elements of financial income and expense is discouraged. The measurement of financial cost can be significantly affected by an enterprise's accounting policy for capitalisation of interest. Where it is the policy of an enterprise to capitalise interest, this fact and the amount capitalised during the reporting period should be disclosed.

Conclusions

In the light of the foregoing, the following clarification is given:

"Financial income and expense should be disclosed separately without set-off and, where material, the different elements of income and expense should be disclosed."

3. Prior year items

Rationale for disclosure under this item

In an accounting period reported results may be affected by items not related to that period. In order to enable the user of financial statements to identify properly the results arising in the current period and to assess an enterprise's performance, prior year items should be subject to consistent accounting treatment and should be disclosed separately.

Issues for clarification

The following issues have been identified:

- The need for consistency of accounting treatment and proper disclosure of prior year items;
- Identification of common elements for a definition of these items.

Separate disclosure of prior year items is widely accepted practice. With respect to the accounting treatment of such items, one view is that items relating to prior years should be excluded from the current year's results and that opening reserves should be adjusted to take account of these items. It is, however, increasingly recognised in the majority of Member countries that all transactions or operations should be reflected in the income statement and should not be debited or credited directly to reserves. An important advantage of this approach is that the user of the financial statements is presented with an all inclusive picture of an enterprise's performance through examination of its income statement.

Differences of opinion exist as to the definition of a prior year item. It is required practice in some countries to disclose the effect of changes in accounting bases and to disclose corrections of a fundamental error in prior year accounts. There is agreement, however, that prior year items should include corrections of errors in prior year accounts.

This common element is not intended to cover simple changes in or corrections of estimates included in prior year accounts for the purpose of preparing the financial statements. In some countries corrections of these estimates are shown as prior year items. However, it can be argued that corrections of such estimates are normal, will occur in every accounting period and, therefore, are unlikely to distort reported results from year to year. If a fundamental error as opposed to a change in estimate occurs in the calculation of such estimates then the effects of the correcting entries should be reported separately as prior year items.

Conclusions

Taking into account the foregoing considerations, the following clarification is given:

"Prior year items should be separately disclosed; they include in particular corrections of fundamental errors in prior year accounts."

4. Income tax

Rationale for disclosure under this item

It is important for the user of financial statements to be able to ascertain the normal tax charge related to an enterprise's ordinary activities. To obtain this information disclosure is necessary of distorting factors such as the impact of tax on extraordinary items.

Issues for clarification

The following issues call for clarification:

- The need for separate disclosure of tax charges relating to extraordinary items so as to show the tax charge relating to ordinary activities;
- The methods used to account for deferred taxes.

i) Tax charges relating to extraordinary items

To facilitate inter-enterprise comparisons, it is generally felt that separate totals of pre-tax results, taxation and net results should be disclosed in the income statement. Just as separate disclosure of extraordinary/unusual items is necessary for a user to review an enterprise's performance, it is desirable that the tax effect of such items be isolated so as not to distort that part of taxation relating to normal operations. This can be achieved by disclosing the two elements separately.

ii) Accounting for deferred taxes

In most countries, the amount of income tax payable is not the same as that which would be payable if the tax rate were applied to pre-tax accounting income. The rules governing the determination of taxable income differ, on certain points, from the principles applied in accounting, so that, to determine the tax base, pre-tax accounting income has to be adjusted.

The purpose of these adjustments may be to exclude certain expenses from charges or to defer, until a later accounting period, the deduction of certain expenses which the tax authorities will allow only at the time these expenses are paid and not when they are committed or reported. Or, on the other hand, tax rules may provide that certain revenues need not be included in taxable income, either because tax on them has already been paid, or because they will be taxed at the time cash is collected.

Adjustments vary widely according to the country concerned, since each country has its own specific tax rules. However, two main categories can be distinguished:

- Adjustments that are permanent in nature, the tax authorities considering for example that the expenses or revenues concerned are always to be excluded in determining the tax base;
- Adjustments relating to expenses or revenues for which the period of inclusion in taxable income differs from the period of inclusion in accounting income.

Adjustments in the former category are generally described as permanent differences, while those in the latter category are known as timing differences.

As regards income tax accounting, views are already converging. Thus, it is increasingly recognised that there should be accounting for deferred taxes, at least in the consolidated accounts.

However, substantial differences of views remain concerning in particular the extent to which timing differences are to be taken into account. Some believe that only a portion of the differences between pre-tax accounting income and taxable income should generate deferred taxes; others argue that deferred tax accounting should be based on the total amount of this difference.

As long as these divergencies persist comparability can be increased in supplementing the financial information given in the income statement and in the balance sheet with disclosure in the notes to include, in particular, a precise description of the method used for determining deferred taxes and the amount of deferred taxes not accounted for because of the use of the partial tax allocation method.

Conclusions

In the light of the foregoing considerations, the following clarification is given:

"Income tax amounts should be separately disclosed and separate totals should be provided for pre-tax and net results;

Taxation relating to extraordinary/unusual items should be isolated from the tax charge in respect of ordinary activities and separately disclosed;

The methods used for determining deferred taxes should be disclosed."

5. Depreciation

Rationale for disclosure under this item

It is important for the user of financial statements to be informed of an enterprise's policy and charge for depreciation of its assets in order to be able to assess and to compare its performance.

Issues for clarification

The following issues have been identified for clarification:

- The need to disclose sufficient information relating to depreciation;
- The need to provide information on the accounting methods used.

The need to depreciate tangible assets is broadly accepted in Member countries although the bases applied show a wide divergence in practice. Exceptionally, in a few Member countries certain assets are not depreciated for specific reasons. Buildings are not always depreciated on the grounds that their value normally increases.

Different methods of depreciation (declining balance, straight line usage, etc.) are used, to varying degrees, in Member countries. Each method may be appropriate in differing circumstances and no one method can reasonably be recommended, but in the interest of comparability of the financial statements the methods used should be disclosed.

Because rates of depreciation of similar assets may vary widely, and thereby affect comparisons of reported results, it is important that such rates be disclosed. Where depreciation charges are booked for tax purposes only, their effects on the results should be disclosed.

Conclusions

In the light of the foregoing, the following clarification is given:

"Fixed (long-term) assets which have a limited life should be depreciated on a systematic basis and exceptionally, where under national practice a fixed (long-term) asset is not depreciated, this fact should be disclosed together with the reasons therefor.

The depreciation charge should be disclosed separately. Where part or all the depreciation is charged for the purpose of obtaining a tax advantage, this fact and the relevant amount should be disclosed.

For principal categories of fixed (long-term) assets the financial statements should indicate the method of calculating depreciation, changes in these methods and the useful lives of the assets or the rates applied."

6. Foreign currency translation

Rationale for disclosure under this item

Differences arise from translation of foreign currency financial statements or transactions and can be significant enough to influence reported results. Differences frequently arise because of factors not directly related to an enterprise's operations and separate disclosure is therefore necessary.

Issues for clarification

It is widespread practice to disclose exchange gains and losses although often as one composite figure. As already noted, differences are likely to arise both on the translation of financial statements and transactions. The former will only arise on consolidation and such differences arising have no common relationship with differences resulting in the liquidation of transactions. Therefore, such items should be disclosed separately where material.

The Working Group's report on *Foreign Currency Translation* published in 1986 has revealed a wide divergence of practices among Member countries in the area of foreign currency translation with regard to the rates used in translating the various items expressed in foreign currency and the treatment of the resulting translation differences in the financial statements of the enterprise as a whole. Nevertheless, in the latter field, a trend toward greater harmonization of approaches has emerged, in particular with respect to the translation of foreign currency financial statements on the basis of the so-called net investment approach. As set out in the report, the differences arising from the translation into the reporting currency of the net investment attributable to such components of the enterprise as a whole which operate as self-sustaining entities in another currency are, as long as and insofar as the net investment is not discontinued, segregated from that enterprise's net income by taking them directly to its equity[5]. Any translation differences related to operations in a currency other than that of the self-sustaining entity to which they belong are, in the case of monetary items and where considered appropriate after a deferral period, included in that entity's results and consequently also in the net income of the enterprise as a whole. However, in a situation where the currency of a self-sustaining entity is affected by a high rate of inflation, the net investment approach is sometimes abandoned, all translation differences being included in the net income of the enterprise as a whole.

Pending further efforts towards harmonization it is necessary in the interests of comparability to provide adequate disclosure of the methods used for translating foreign currency financial statements and foreign currency transactions and of the effects of these methods on the items included in the financial statements.

Conclusions

In the light of the foregoing considerations, the following clarification is given:

"The financial statements should disclose the methods applied for translating into the reporting currency the elements of the balance sheet and income statement denominated in foreign currency.

The aggregate exchange gains and losses for the period included in determining net income and, where applicable, the net difference on translation for the period taken to equity should be disclosed."

D. NEW CAPITAL INVESTMENT

Rationale for disclosure

Information on capital investment is generally considered to be of interest to the users of financial statements because it could provide an indication of an enterprise's effort to maintain or improve its productive capacity and hence to maintain employment. It may also provide an indication of the impact of technological change on an enterprise's financial statements and, in times of high inflation, for those enterprises which do not provide inflation adjusted financial information, the level of new investment can provide useful information in addition to depreciation based on historical cost.

Issues for clarification

The following main areas for consideration in reaching clarification on new capital investment are examined below:

- The scope of the term "new capital investment";
- The distinction between new investment and replacement investment;
- The treatment of leased assets;
- The treatment of investment grants.

i) The scope of the term "new capital investment"

The objective of providing to the user an indication of an enterprise's effort to maintain its position would be best served by retaining movements concerning all categories of fixed or long-term assets in a proposed definition of investment. It is also recognised that the objective of providing to the user an indication of future operating capability and capacity to maintain employment would be best served by separate disclosure of investment in tangible assets or investment in land, building, plant and equipment. The methods used for accounting for investment in associated enterprises require separate consideration in the context of consolidation.

ii) The distinction between new investment and replacement investment

In considering tangible assets or land, building, plant and equipment assets, it is difficult if not impossible to identify what is a capacity increase in a situation which involves any form of replacement or extension. A pragmatic solution would be to simply include in the disclosed items additions to tangible assets or to land, building, plant and equipment assets, whether new investment or replacement in the period. In this case the information would be on capital expenditure in the period and not on "new" capital expenditure.

iii) Treatment of leased assets

Of all the twenty-four OECD countries only a few require the capitalisation of leases but it is either in the process of becoming, or is already, predominant practice in some countries[6]. Where capitalisation is required, this is because the belief is held that the leasing arrangements, in the defined circumstances, are really of a financing nature and that the transaction is equivalent to a purchase by instalments. The question then arises of whether such "purchases" should be included in disclosure requirements for "capital investment".

At present, in view of the conditions presently prevailing in OECD countries and with a view to simplicity (the additions to be disclosed should be capable of being obtained directly from the financial statements), it is suggested that additions should be reported based on current national practice. Therefore if leases are, at present, capitalised, the resulting additions to fixed assets or long-term assets should be so reported. If leases are not capitalised, clearly they should be excluded. However, in the interest of comparability of information, the positions taken by enterprises in accordance with national practices should be indicated in the notes to the accounts.

iv) Treatment of investment grants

In a significant number of Member countries investment grants are available to enterprises to encourage investment in defined regions or sectors of activity. The advantage to the enterprise can be fiscal, financial or both. Accounting for such grants varies within the OECD Member countries based on national practices and the differing nature of the grants themselves. Grants received may be either credited to income as received or serve to reduce the cost (and hence depreciation) of the asset acquired. Some Member countries require the disclosure of gross additions under capital investment including investment grants, in others such grants are excluded.

From the point of view of the enterprise concerned, investment grants may not affect the operational value of the assets acquired. On the other hand, for potential investors and other users of the accounts the total amount of capital expenditure (including the part financed by grants) may provide useful information as to the development of the productive capacity of an enterprise. It was pointed out, however, that enterprises may encounter difficulties to provide comparable data, given the diversity of the forms of official incentives to investment. Taking into account these various interests and the divergence of practices in Member countries, it was agreed that this matter should be left to national practices. In the interest of transparency the positions taken by enterprises in conformity with such practices should be indicated in the notes to the accounts.

Conclusions

In the light of the considerations above, the following clarification of "new capital investment" is given:

> **"Expenditure for the acquisition of, the replacement of, or improvements to, assets, other than current assets, intended for the use on a continuing basis in the enterprises' activities. The amount disclosed should distinguish between tangible assets, intangible assets and financial assets."**

E. SOURCES AND USES OF FUNDS

Rationale for disclosure under this item

It is the purpose of the disclosure of sources and uses of funds to provide information as to how the activities of the enterprise have been financed and how its financial resources have been used in the period covered by the statement. It is designed to present information that the balance sheet, the profit and loss account and the related notes either do not provide or provide only indirectly. It assists users of financial statements in interpreting the reported operating results to judge the economic performance of an enterprise and the effectiveness of the management of its financial resources.

Issues for clarification

There is little common ground among Member countries as to the presentation of the funds statement and as to the content of such a statement. It is generally recognised, however, that information under this item is useful and that disclosure should preferably be made an integral part of the financial statements. In this context the following issues are considered:

- The definition of funds and the presentation of the statement;
- Treatment of extraordinary/unusual items;
- Presentation of gross rather than net figures.

i) Definition of funds and the presentation of the statement

One of the principal difficulties associated with the presentation of a funds statement arises from the interpretation placed on the word "funds". Funds can be defined as cash or cash equivalents, as working capital or using the broadest definition of all as financial resources arising from transactions with parties outside the business. The latter two concepts of funds will include the financial aspects of all significant transactions whereas the first concept would be restricted to transactions in cash.

The different definitions available reflect the different approaches to the objective underlying the statement. If disclosure of working capital is considered appropriate in the circumstances of a particular enterprise, then a working capital definition of funds would be best. If it was desired to place more emphasis on liquid assets, a cash type definition would be better. Finally, the broadest concept mentioned in the preceding paragraph is based on the premise that the most useful form of a funds statement is one that reports all significant inflows and outflows of financial resources during the period by major categories, without special emphasis on the changes in a particular asset or groups of assets, but showing separately the funds provided by (or used in) normal operations including items in operations not requiring funds.

In view of these differences the definition of "funds" should be left to national practice. Nevertheless whatever definition is adopted the information disclosed should be sufficient to show separately movements in the elements of funds based on one of the three concepts most commonly employed (cash and cash equivalents, working capital and financial resources arising from transactions with parties outside the business). No attempt has been made to develop a detailed format for the presentation of the statement.

ii) Treatment of extraordinary/unusual items

As is the case in connection with the income statement, there is general agreement that it is important that movements of funds relating to items of an extraordinary nature should be disclosed separately, so that financial statement users can better appreciate movements relating to normal operations. Possible definitions of extraordinary/unusual items are examined separately in connection with operating results. The items disclosed in the funds statement should be described in a manner consistent with the income statement terminology.

iii) Presentation of gross rather than net figures

There is general agreement that significant movements of funds should be shown gross and should not merely reflect the net change. It would defeat the objective of the statement if two major transactions (e.g. a sale and a purchase of long-term investments) were simply reported as a net source or use of funds.

Conclusions

Taking into account the foregoing considerations the following clarification of the item "sources and uses of funds" is given:

> **"The information disclosed under 'sources and uses of funds' should show movements in cash or cash equivalents, working capital or financial transactions with parties outside the business. Funds provided from or used in the operations of an enterprise should be presented in the statement separately from other sources and uses of funds. Extraordinary/unusual items should be separately disclosed in the statement. Each enterprise should adopt the form of presentation for the statement of sources and uses of funds which is most informative in the circumstances."**

F. AVERAGE NUMBER OF EMPLOYEES

Rationale for disclosure under this item

Disclosure of the average number of employees during an accounting period permits a comparison of employment trends from period to period and coupled with other information on sales, for example, it enables inter-enterprise comparisons to be made. When total labour costs are provided, data on the average number of employees enable average employee earnings comparisons to be made and calculations of value added, contributed to the business by the employees.

Issues for clarification

The main areas for consideration for reaching a fair assessment of the average number of employees are the treatment of:

- Seasonal factors;
- Temporary employment;
- Part-time employment.

Seasonal variations of employment are important for some enterprises, notably those involved in a traditionally seasonal business. Some enterprises make significant use of temporary employment and part-time labour. Where seasonal variations of employment, temporary employment, or part-time employment have a significant impact on the average number of employees, this impact should be shown separately in the published reports.

So far as the methodology for the calculation of the average is concerned, there is a large variety of approaches in Member countries. In one country, for instance, the method utilised is to divide the total number of hours of work in the enterprise during the year by the standard annual number of working hours for an individual. In another it is the average number of employees at the end of each quarter. An alternative approach is to disclose the number of employees at the end of the fiscal period. Many countries do not prescribe any specific method for the calculation of the average number of employees.

Conclusions

In the light of the considerations above the following clarification on "average numbers of employees" is given:

> **"The average number of persons employed by the enterprise during the accounting period. The method used to calculate the average should provide a fair assessment of the average number of employees. This average should reflect the effects of seasonal employment, temporary employment and part-time employment, and where these factors are significant, their effects and the method used in assessing them should be indicated in the published reports of the enterprise."**

G. RESEARCH AND DEVELOPMENT EXPENDITURE

Rationale for disclosure under this item

Disclosure of research and development expenditure and its treatment is important to the users of financial statements because it could be indicative of the possible future development of an enterprise. Such information may reflect an enterprise's potential to maintain or improve its profitability, competitiveness and growth.

Issues for clarification

The main issues for consideration in determining the meaning of research and development expenditure arise from:

- The defining of research and development activities;
- Cost to be included;
- Government grants;
- Practices relating to expensing or deferral of development costs.

i) The defining of R & D activities

In considering a common approach to the definition of research and development activity[7], comparison of the existing definitions shows the following common elements in the definition of research expenditure:

- The work must be investigatory in nature;
- It must be aimed at obtaining new scientific or technical knowledge;
- The work must be planned.

Common ground also exists as to the nature of the development process. Development is generally understood as being the translation of research findings or other technical knowledge in order to produce new or significantly improved products or processes either for sale or use by the enterprise. Development does not include alterations to existing products or processes unless the alteration effectively creates a new product or process. Market research activities prior to the commencement of production which are designed to demonstrate the commercial viability of a new or significantly improved product appear to be similar to development and if treated in a similar manner should be disclosed separately.

ii) Cost to be included

Available definitions generally require inclusion of all attributable costs in research and development expenditure which will include direct costs (e.g. material and labour) and to the extent permitted by national practice, indirect costs (e.g. depreciation, amortization and overhead). A significant problem in relation to costs is the need to establish a "cut-off" point between pre-production and production costs. Whilst compilation of a list of activities that typically would or would not be classified as research and development expenditure might be of use, such a list is unlikely to be comprehensive enough to cover all situations and a degree of judgment will always be necessary.

iii) Government grants

The question of whether to show research and development expenditure either before or after government grants has been raised. It is likely that the gross expenditure is more informative to the user of financial statements, although given the diversity of the forms of government incentives, enterprises may encounter difficulties in providing comparable data. These difficulties cannot be easily resolved and would merit further study in the general context of accounting for government grants. In the meantime the most satisfactory solution would be for enterprises to disclose the policies adopted in the notes to the accounts where grants received are significant.

iv) Expensing or deferral of development costs

In view of the uncertainties concerning future benefits resulting from development expenditure and the difficulty of relating benefit to cost, there should be a presumption for expensing rather than deferral. Where deferral is permitted by national practices under clearly specified circumstances, the movement in, and the balance of, unamortized deferred development costs should be disclosed together with the basis of amortization.

Conclusions

In view of the foregoing considerations, the following clarification of "research and development expenditure" is given:

"Research is considered to have the following common elements:

i) **The work is of an investigatory nature;**
ii) **The purpose is to obtain a new scientific or technical knowledge;**
iii) **The work is planned.**

Development is considered to be the translation of research findings or other technical knowledge in order to produce new or significantly improved products or processes prior to sale or use by the enterprise. Development does not include alterations to existing products or processes unless the alteration effectively creates a new product or process.

Research and development costs should include direct costs (e.g. material and labour) and to the extent permitted by national practice, indirect costs (e.g. depreciation, amortization and overhead).

Enterprises should disclose their accounting treatment of government grants or other aid received for research and development."

H. POLICIES FOLLOWED IN RESPECT OF INTRA-GROUP PRICING

Rationale for disclosure

Without disclosure to the contrary, there is a general presumption that transactions reflected in financial statements have been consummated on an arm's length basis between independent parties. However, that presumption is not necessarily justified in relation to intra-group transactions. Because it is possible for such transactions to be arranged to obtain certain results desired of the related parties, the resulting accounting measures may not represent what they usually would be expected to represent. In other words, without some disclosure of the transfer pricing policies adopted by enterprises, the reader of the financial statements cannot be sure of the reliability of the amounts used to measure intra-enterprise transactions. In particular, the disclosure of transfer pricing policies will assist in the understanding of financial statements where segmented information is presented.

Issues for clarification

In view of developing clarifications on item *viii)* of the disclosure of information chapter of the Guidelines, the following issues can be identified:

a) What is the nature of information to be disclosed under the item "transfer pricing policies"?
b) Should disclosure concern only transfer pricing policies followed at the level of a group or should it also specify practices applied by individual enterprises?

As stated in the introductory consideration of this chapter of the Guidelines, disclosure of information by multinational enterprises is to provide information on the structure, activities and policies of the enterprise as a whole. As intra-group transactions and balances are eliminated in consolidation, the Guidelines do not require disclosure of specific information on such related party transactions. However, the disclosure of transfer pricing policies called for in item *viii)* adds an important element of non-financial information for the users of the accounts. As indicated by the use of the term "policies", disclosure under this item would not imply detailed information on transactions and balances between related parties, but rather an indication of the general approaches followed by the enterprise in the setting of transfer prices for such transactions. As a minimum, enterprises should state the methods used. More specifically, they should indicate in their financial statements whether transfers have been made following market prices or, in the absence of such prices, following other methods such as those described in the 1979 OECD report on *Transfer Pricing and Multinational Enterprises.*

Disclosure of transfer pricing policy would normally relate to the policy followed at group level, and thus would not have to specify practices applied by individual group companies unless significant differences existed between the group policy and that of individual enterprises.

Conclusions

In the light of the foregoing considerations, the following clarification is given:

"Under the item 'policies used in respect to intra-group pricing', enterprises should indicate in their financial statements the general approaches they follow in the setting of prices for intra-group transactions. In particular, they should indicate whether transfers have been made following market prices or, in the absence of such prices, following other methods which should be specified."

I. ACCOUNTING POLICIES

Rationale for disclosure under this item

Accounting policies adopted have a direct effect on the financial position and results of operations of the enterprise as reported in the financial statements and because a choice of policies often exists, disclosure is vital for a proper understanding of the financial statements. Furthermore, disclosure of accounting policies helps the user compare financial statements of different enterprises, and for a given enterprise, permits inter-period comparisons.

Issues for clarification

There is a common view among OECD countries as to the objective for disclosing accounting policies and national practice and existing international standards show a considerable degree of convergence. The following issues call for clarification:

- The definition of accounting policies as distinguished from basic accounting assumptions which usually are not disclosed;
- The scope of disclosure under the item "accounting policies";
- The disclosure of the effects of changes in accounting policies.

i) Definition of accounting policies

Accounting policies can be understood to include the principles, bases, conventions, rules and procedures used by companies in preparing and presenting financial statements. They refer to all items of the accounts where a choice of basis has to be made by the enterprise in order to apply certain fundamental concepts and where that choice will have a significant impact on the information disclosed in the accounts.

Understood in this sense accounting policies can be distinguished from fundamental assumptions which either underlie the preparation of financial statements which are to show a "true and fair" view or are designed to guide the selection of accounting policies; these include going concern, consistency, accrual, prudence, substance over form and materiality.

The acceptance and use of these fundamental assumptions and principles is assumed and, therefore, to the extent they are followed, no specific statement is normally required. However, departures from these assumptions and principles should be stated together with the reasons for such departures.

ii) Scope of disclosure under "accounting policies"

In this respect two main approaches can be discerned in Member countries. While a number of countries require the disclosure of all significant accounting policies having an impact on the financial statements, others require such disclosure only in specifically enumerated circumstances (e.g. valuation methods). As item *ix)* of the chapter on disclosure of information of the Guidelines does not contain any enumeration or limitation and in view of the overall purpose of this chapter "to improve public understanding", it is suggested that the concept of disclosure of accounting policies should be understood in a broad sense rather than seeking to provide an enumeration of specific areas for which policies should be disclosed. In using their judgment, enterprises should be guided by the principles mentioned in the preceding paragraphs and, accordingly, should state all policies which are significant to the determination of financial positions, changes in financial position and the results of operations.

iii) Disclosure of the effects of changes in accounting policies

It is generally accepted in Member countries that accounting policies should be consistently applied by an enterprise from year to year. Exceptionally there may be reasons for changing such policies in which case it is necessary, where the effects are material, to disclose such changes, to explain the reasons therefor and to indicate the effects thereof.

Conclusions

In the light of the foregoing considerations, the following clarification of "accounting policies" is given:

"Accounting policies include the principles, bases, conventions, rules and procedures used by an enterprise in preparing and presenting financial statements. They refer to all items of the accounts where a choice of basis has to be made by an enterprise in order to apply

certain fundamental concepts and where that choice will have a significant impact on the information disclosed in the accounts.

All significant accounting policies used should be clearly disclosed in financial statements. Accounting policies should be applied consistently from year to year. Exceptionally, where an accounting policy is changed with material effect, the change should be disclosed together with the reasons and an indication of its effects."

J. CONSOLIDATION POLICIES

Rationale for disclosure

As stated in the introductory section of the chapter on disclosure of information of the OECD Guidelines, it is the objective of this chapter to improve public understanding of the structure, activities and policies of the enterprise as a whole. The Guidelines therefore reflect the needs of a wide range of users of published accounts. They also reflect the recognition that individual accounts prepared by component entities of a group according to local rules and practices are in themselves not sufficient to provide a true and fair view of the enterprise as a whole. The need for consolidated financial statements is evident and accepted throughout the OECD area.

Basis for clarification

Consolidation is specifically mentioned in item ix) of the disclosure chapter of the OECD Guidelines in connection with accounting policies. In addition, this chapter contains a number of statements and references which are of particular relevance to consolidation.

Although no precise legal definition is intended, paragraph 8 of the introductory chapter of the Guidelines provides a general description of multinational enterprises to which the Guidelines, including those on disclosure of information, are addressed. These enterprises "usually comprise companies or entities whose ownership is private, state or mixed, established in different countries and so linked that one or more of them may be able to exercise a significant influence over the activities of others and, in particular, to share knowledge and resources with others". The Guidelines are addressed "to various entities within the multinational enterprise (parent companies and/or local entities) according to the actual distribution of responsibilities among them on the understanding that they will co-operate and provide assistance to one another as necessary to facilitate observance of the Guidelines".

It is the term "enterprise as a whole" which is the key notion of the disclosure chapter of the Guidelines. This concept implies the preparation of consolidated accounts of the enterprise as a whole since consolidation has been recognised as the most appropriate way to present the entities included as if they were a single enterprise. As there is still a wide divergence of consolidation practices in Member countries as a result of national and regional requirements with which multinational enterprises have to comply, it is important that enterprises indicate the methods they apply in preparing consolidated financial statements including, in particular, the items enumerated below.

While the clarification below addresses the basic aspects of consolidation policies under the Guidelines, there are a number of important aspects covered by an OECD survey on consolidation policies where greater international harmonization of accounting practices would enhance the comparability of information disclosed by multinational enterprises and facilitate the mutual recognition of consolidated financial statements. These issues will be dealt with in a separate report.

Conclusions

In the light of the foregoing, the following clarification of the term "consolidation policies" in item *ix)* of the disclosure of information chapter of the Guidelines is given:

"Multinational enterprises as defined in the OECD Guidelines should prepare consolidated accounts in accordance with the recommendations set out in the disclosure of information chapter of these Guidelines. Adequate information should be disclosed on the methods used for consolidation, in particular:

- **The principles adopted in determining the inclusion and exclusion of entities in the consolidated financial statements;**
- **The method used to account for unconsolidated subsidiaries and associated enterprises;**
- **The accounting treatment of the effects of intra-enterprise transactions and balances;**
- **Any changes in the composition of the enterprise as a whole."**

K. SEGMENTATION OF INFORMATION

Rationale for disclosure of segmented information

The size and complexity of many enterprises means that normal disclosure requirements are often insufficient to permit users of financial statements to be able to evaluate reasonably the performance of those enterprises. The diversity of such operations both in terms of different markets and lines of business results in a need to disclose information relative to operations and markets so as to permit an assessment of their contribution to overall results and the performance of the enterprise as a whole.

Under the Guidelines, the type of segmented information to be disclosed is described as follows:

"...

iii) The operating results and sales by geographical area and the sales in the major lines of business for the enterprise as a whole;

iv) Significant new capital investment by geographical area and, as far as practicable, by major lines of business for the enterprise as a whole;

v) ....

vi) The average number of employees in each geographical area."

Issues for clarification

The recommendations of the Guidelines with respect to the disclosure of segmented information, go beyond the actual requirements and practices in most Member countries. This underlines the need to elaborate common definitions in this area in order to facilitate observance of the Guidelines by the enterprises concerned. In this respect it was decided to focus on the identification of the segment to be reported. Other issues of relevance for disclosure of segmented information relate to the allocation of common cost, revenue and other items between segments.

The disaggregation of financial information involves the rational allocation of amounts that are common on the basis of usage or other relevant criteria. Some items, however, cannot be allocated on a basis that is other than arbitrary. Therefore, disaggregated data often are stated at some intermediate point between revenues and net income or loss. Comparability of reported operating results on a geographical basis, as stipulated in the Guidelines, may be enhanced if the term "operating results" is understood to mean income from normal trading activities before interest expense, income taxes, and revenues and expenses incurred at the corporate (parent company) level which are not derived from the operations of any industry or geographic segment.

i) Major lines of business

Whilst it is accepted that reporting of segmented information by industry is desirable, any definition of "major lines of business" industry segments is faced with the diversity of enterprises. Therefore, of necessity, any definitions on this subject must be general. However, the utility of the information to the user is of prime importance and therefore there should be an emphasis on the need to produce meaningful segmented data. Thus reportable industry segments should take account not only of the different types of products or services of an enterprise but also of their different characteristics such as profitability, degree of risk and rate of growth. The production processes and eventual markets for products should also be considered. Normally where, within an enterprise, different operations are linked in a vertical chain these operations will form part of the same segment and it is the end product of this chain supplied to third parties, which could serve as the basis for determining the industry segment.

ii) Geographical area

The geographical areas are those "where operations are carried out and the principal activities carried on ...... by the parent company and the main affiliates" [item *ii)* of the chapter on disclosure of information]. Further precision is given by the definition contained in the footnote to item *ii)* of this chapter of the Guidelines. This definition which is an integral part of the Guidelines allows sufficient flexibility while at the same time stating a few important criteria to be taken into account by enterprises in providing information by geographical area.

Conclusions

In the light of the foregoing, the following clarification concerning the identification of reportable segments is given:

> **"Major lines of business are the distinguishable components of an enterprise each engaged in providing a different product or service, or a different group of related products or services, primarily to customers outside the enterprise. When assessing the distinguishable components for disclosure, account should be taken of their importance to the business."**

With respect to "geographical areas" reference is made to the definition contained in the footnote to *ii)* of the chapter on disclosure of information of the Guidelines which reads as follows:

> **"For the purposes of the guideline on disclosure of information the term 'geographical area' means groups of countries or individual countries as each enterprise determines is appropriate in its particular circumstances. While no single method of grouping is appropriate for all enterprises or for all purposes, the factors to be considered by an enterprise would include the significance of operations carried out in individual countries or areas as well as the effects on its competitiveness, geographic proximity, economic affinity, similarities in business environments and the nature, scale and degree of interrelationship of the enterprise's operations in the various countries."**

III. SPECIFIC CLARIFICATIONS: FINANCIAL SERVICES

As stated in paragraphs 8 and 9 of the introduction to the Guidelines, these are addressed to all multinational and – where relevant – national enterprises, whatever their nature, structure and area of activity, whether commercial, industrial or in the field of services. Nevertheless, specific issues may arise with respect to the Guidelines in the field of services, on account of certain special features in that sector. Such problems have been identified in particular in the area of disclosure of information. The following chapter deals with specific accounting and reporting problems arising in the banking and insurance sector.

A. APPLICATION OF THE OECD GUIDELINES TO DISCLOSURE OF INFORMATION BY BANKS

The question dealt with here is the extent to which the accounting concepts contained in the Guidelines on disclosure of information are directly applicable to banks and similar institutions.

With respect to the special features of banks which affect disclosure of information, the main points to be stressed are the following:

a) Banks are service enterprises, so that their fixed assets are normally small in relation to their business turnover (i.e. their capital-intensiveness is low) while their staffing costs are high;

b) Banks are institutions which influence the monetary flows of the nations in which they are established, so that governments in all countries have thought it advisable to regulate not only their activities but also the information they provide periodically to the authorities; while, in addition, in many countries, the banks' financial reports are subject to special rules under legislation or regulations laid down by the banking authorities and therefore differ from those of other businesses and also from those of banks in other countries;

c) Although the professions normally grouped under the name of "banks" are in practice somewhat heterogeneous, most of the international firms are "universal banks" or "deposit banks", i.e. institutions a large part of whose business consists in taking in deposits and granting credit for varying periods. As a result, inward and outward movements of funds are very numerous and their total very high in relation both to the level of their assets at a given date (balance sheet) and to the amounts which the bank charges its customers (operating results). In the following section, certain conclusions are drawn from these special features with a view to selecting the type of information that appears to be most meaningful for disclosure.

In view of these special features, it is important to stress two guiding principles that must be observed in the choice of ways of applying the Guidelines to banks:

i) One aim of providing the public with useful information in the general framework of a better understanding of the multinational enterprises implies that the information disclosed by banking institutions should be as equivalent as possible to that given by other enterprises;

ii) On the other hand, in all the countries or groups of countries (EEC) studied, it has been found necessary to work out a different basis for disclosure by banks of significant elements in their financial statements.

On two points, it had to be recognised that banks have difficulties in complying with the recommendations of the Guidelines which the general clarifications do not resolve: these arise with "sales", and concern the meaning to be given to that term where banking services are concerned, and "operating results", for similar reasons. Among the other points in the chapter on disclosure of information, some can be seen to be of relatively limited importance for most of the banks; this is the case, in particular, with "new capital investment" and "research and development expenditure".

1. Recommendations on disclosure not calling for specific clarification

i) Structure of the enterprise

The general clarification of this item is fully applicable to banks.

ii) Activities and geographical areas

The text of paragraph *ii)* of the Guidelines on disclosure, and the footnote thereto, are fully applicable to banks.

iii) Significant new capital investment

The general clarification of new capital investment is fully applicable to banks. Considering the comparatively small size of banks' tangible fixed assets in relation to their level of business, it is recognised that disclosure of "new capital investment" is of limited importance for banking activities. Nevertheless, in certain instances, disclosure of new capital investment may be an important indicator, especially with regard to multinational banks, of their geographical penetration within the country of origin and within any new or prospective host countries. In addition, where the enterprise is engaged in non-banking activities, information on new capital investment can be useful and should be disclosed in conformity with the clarifications.

iv) Statement of sources and uses of funds

The general clarification of "sources and uses of funds" is fully applicable to banks.

v) Average number of employees

The definition of "average number of employees" provided in the general clarification does not appear to raise any particular problems in the banking sector.

vi) Research and development expenditure

Where industrial enterprises are concerned, research and development expenditure can reveal an aptitude of the enterprise to maintain or improve its profitability, competitiveness and growth. Without denying the validity of technical research into financial innovation and banking techniques, the amounts of research and development undertaken by the banks themselves seem in most cases to be too small to be given systematic mention.

The general clarification of "research and development expenditure" is applicable to banks. However, it is recognised that figures under this heading may not be supplied by banks except insofar as expenditure during the period under review was significant.

vii) Intra-group pricing policies

Examination of this problem did not reveal any need for a specific clarification. The general clarification should make it easier for enterprises – banks and others – to comply more closely with the recommendation in the Guidelines concerning disclosure of their policies in respect of intra-group pricing.

viii) Accounting policies including those on consolidation

The general clarification applies to banks without reservation.

ix) Segmentation of information

The definition of segments given in the general clarification is fully applicable to banks.

2. Specific clarifications related to accounting and reporting by banks

i) Sales

A bank can receive and lend one and the same amount on several occasions during the same accounting period; can it be stated that a "sale" has taken place each time the enterprise lends money? In fact, what the bank earns through such an activity may be almost exactly the same if the amount is lent just once for the whole of the year. This reasoning shows that for a bank the item "sale" or "turnover" is not meaningful and that an equivalent concept has to be found to indicate its level of activity.

In view of the clarification already given it has to be determined what, in the case of banks, is the financial information most closely equivalent to "sales" in other enterprises. Allowing for the repetitive nature of the money flows involved, it is not really possible for a bank to consider as "sales" the total funds or securities that have changed hands between it and its customers during the period, but rather what it charges them over and above mere repayment claims. This amount charged to customers is made up mainly of interest (remuneration of capital multiplied by time) and commissions related to lending operations (remuneration for work). Whatever the difference in nature between these two sorts of income, their sum would appear to be a figure deserving to stand as the nearest equivalent to sales in the case of industrial or commercial enterprises. There are other revenue items such as income from leasing activities, service charges for deposit accounts, commissions from exchange and securities transactions, which are also relevant in this context.

A source of ambiguity needs to be cleared up where transactions are concerned. In some countries, the custom is for banks to publish only a *net* figure, that is, interest and commissions charged, minus interest and commissions paid. It is difficult to treat this as being equivalent to the sales of a commercial firm. Purchases are never deducted from sales when the figures stated to represent turnover or sales are published. Moreover, in the most recent standardization text drawn up, i.e. the EEC Directive on Annual Accounts by Banks, the profit and loss accounts have to show gross figures, without deduction, for the items "interest received" and "commissions received".

Another clarification is also necessary. Is the sales figure to be given on one line only or in two different figures, so as to give separate information on the interest charged and on the commissions and the charges for services? In many countries, the rules governing the publication of banks' accounting data require that these two figures be given separately and the EEC Directive mentioned above does make express provision for the distinction to be made.

Income items such as interest and commission charges may not give a complete picture of the scale of activities of a bank. Reference is made in this context to ongoing activities of the Working Group on the harmonization of accounting practices by banks including the use of new financial instruments.

In the light of the foregoing, the following clarification of the term "sales" in paragraph *iii)* of the Guidelines on disclosure is given:

> **"For enterprises in the banking sector, 'sales' should be understood to mean total interest and commission charged. Interest and commission paid should not be deducted. As a general rule, the gross sales figure should be broken down into interest and commission. In addition, other significant operating income related to banking activity should also be disclosed."**

ii) Operating results

In the accounts of the multinational banks, at the level of the enterprise as a whole, figures are usually given for the margin between interest and commission collected and interest and commission paid out. This amount, called "net bank income" (produit bancaire net) in France and "net interest revenue" in the United States, is a very useful item of information, even if it does not include all business income (some kinds of commission are usually omitted). But it is not a complete indicator of profitability, as it does not take account of the other elements of bank costs, such as management expenses which may vary very considerably between banks. The amount best corresponding with the operating results of industrial or commercial enterprises, i.e. business earnings less management costs and before exceptional profits and losses and taxes can be calculated from the financial reports of banks in many countries, even if it is not clearly shown on any one line; and it may therefore be supposed that there would be no technical difficulty in considering it as the most generally accepted way of interpreting the operating results of banks.

However, there is obviously a certain disparity between one bank and another, for they do not all have the same practices with regard to losses caused by customers' insolvency. Losses of interest or capital already incurred, or which the bank considers to be probable given the customer's position, are sometimes debited before calculating the operating results, sometimes entered as exceptional losses, or sometimes even covered by a deduction from profits.

Losses due to customers' insolvency are, of course, a feature of banking operations, so that a true result can in no way be shown until provisions for the period have been set aside. To obtain a good measure of the operating result, suitable for inter-bank comparisons, it should be established after deduction of the provisions for losses on loans that have been written up as such. The constitution or cancellation of a provision involves an element of judgment so that, in the absence of indication of adequate disclosure of the methods used, the comparability of the reports of different banks may be difficult to achieve. Further, the constitution of unduly large provisions, or even of reserves that are not related to any specific risk, is sometimes allowed or recommended by national authorities.

For banks with a portfolio of shares and securities from which they may draw a considerable income and which may be subject to depreciations that are also considerable, the reader needs to know what share of this income and these depreciations are included in the result of ordinary banking activities. It would therefore be desirable that income derived from shares related to banking activity and fixed value investments should be treated as part of the ordinary results, whereas income derived from shares in non-banking enterprises should be treated separately.

To supplement the general clarifications of "operating results" already given, the following clarification concerning banking enterprises is given:

"Banking enterprises should show the results of ordinary banking business after deducting all operating costs including provisions for losses on loans, but before exceptional profits and losses and before extraordinary profits and losses."

B. APPLICATION OF THE OECD GUIDELINES TO DISCLOSURE OF INFORMATION BY INSURANCE COMPANIES

Insurance business, for the purpose of this report is divided into two main categories, life and general. The principal features of each category are:

- *Life insurance:* Policies are mainly long term and generally provide for benefits related to life, death, survival and, in certain cases, disablement of an individual. Profit is recognised only after an assessment of the discounted value of the future stream of income and outgo;
- *General insurance:* Although by comparison with life business general insurance generally covers shorter-term risks, it may involve significant delays on the reporting and settlement of claims (particularly in marine and aviation business and in reinsurance). In many Member countries, therefore, profit recognition on such business may be deferred for one or more financial years.

The general clarifications of the accounting terms in the Guidelines are fully applicable to insurance companies with respect to the following items:

- Structure of the enterprise;
- Sources and uses of funds;
- Average number of employees;
- Research and development expenditure;
- Intra-group pricing policies;
- Accounting policies;
- New capital investment;
- Operating results.

Concerning segmentation of information under the Guidelines, the definitions of line of business and geographic segments given in the 1983 clarifications, constitute a general framework for all category of enterprises. It appeared, nevertheless, necessary to add some specific comments to provide guidance as to how these definitions can be applied in the specific situations of insurance companies.

For the reasons discussed below, the general clarifications relating to sales do not appear to be adequate for insurance companies. A specific clarification is provided which is considered to be equivalent to "sales" under *iii)* of the chapter on disclosure of information of the Guidelines.

1. Recommendations on disclosure of information not calling for specific clarifications for insurance companies

i) Structure of the enterprise

The general clarification of this item is fully applicable to insurance companies.

ii) Statement of sources and uses of funds

There does not appear to be a need for specific clarification of "sources and uses of funds" with respect to insurance companies.

iii) Average number of employees

It is a feature of insurance business that, in addition to the employment of permanent staff, great reliance is placed on independent brokers and agents for the introduction and servicing of business. Whilst disclosure of the numbers of such independent brokers and agents is both inappropriate and impracticable, some indication of the extent to which a company is reliant on these can be ascertained by the amount of commissions paid which is normally disclosed. The general clarification of "average number of employees" does not raise any problems in the insurance sector. Insurance companies should accordingly be encouraged to conform with this recommendation.

iv) Research and development

Disclosure of such information is important to the users of financial statements of manufacturing enterprises because it may reflect an enterprise's potential to maintain or improve its profitability, competitiveness and growth. For insurance companies, most research is into the development and marketing of new policies and expenditure attributable to such research is not separately identified. The rationale for disclosure of information relating to research and development expenditure applies to insurance companies only to a limited extent, if at all, and the amounts involved are in most cases too small to be given systematic mention. Disclosure of qualitative information on innovative techniques or policies may be expected outside of the financial statements, e.g. in the context of the publication of the annual report.

v) Intra-group pricing

There is no apparent reason why the general clarification of this item should not apply to insurance companies.

vi) Accounting policies

There are a number of special features inherent in the nature of insurance business which contribute to making it more difficult for insurance companies to measure profits or losses on an annual basis than is the case for most other types of company.

For example, the delays inherent in the notification and settlement of claims for some types of business, often running into many years, make it very difficult to measure the provisions required for the purposes of annual accounts. In order to make some comparisons possible, information on the calculation of technical provisions should be disclosed. Similarly, the measurement and presentation of the results of an insurance company's investment operations on an annual basis may present difficulties, because annual income and long-term capital growth are both important components in the overall yield and the latter cannot easily be measured meaningfully at annual intervals.

Traditional methods of accounting and presentation have evolved over the years to cope with these and other difficulties and to reflect the particular nature of an insurance company's business.

Disclosure of the above aspects can be made within the scope of the clarification on "accounting policies" which is fully applicable to insurance companies.

vii) New capital investment

It is recognised that expenditure on fixed assets (i.e., for the acquisition of, the replacement of, or improvements to assets other than current assets, intended for use on a continuing basis in the enterprises activities) is generally of limited significance for insurance companies. If, however, such expenditure was significant in a particular accounting year, relevant information would be expected to be disclosed. Assets held in the form of investments by insurance companies are of a different nature to fixed assets of industrial enterprises, as they are held as cover against liabilities arising on insurance policies written.

It is doubtful whether increases in the investment portfolio of an insurance company fall within the scope of "new capital investment". Relevant information relating to changes in the investment portfolio should however be disclosed, preferably in the Statement of Sources and Uses of Funds or by some alternative means such as note disclosure.

The general clarification of new capital investment can be regarded as applicable to insurance companies to the extent that this relates to significant expenditure on the acquisition of, the replacement of, or improvements to assets intended for use on a continuing basis in the enterprises activities. The distinction called for in the general clarification between current and fixed assets on the one hand and between tangible, intangible and financial assets on the other may not be entirely meaningful for insurance companies in light of current national practices whereby assets of those companies are identified under different descriptive headings.

viii) Operating results

Whilst it would be helpful if a common definition of the term "operating results" for insurance companies could be arrived at, this presupposes that the concept has a common understanding in Member countries. Given the variety of current practices, it would be extremely difficult, if not impossible, to adopt a common definition of the term.

The prime need, as recognised in the general clarifications, would appear to be for proper disclosure of all significant items of income, expense, gains and losses. In this respect, similar considerations to those described in the general clarifications apply to insurance companies.

Therefore, in the context of the profit and loss account disclosure should be made not only of the elements comprising the results of trading but also of other elements and of unusual items, non-disclosure of which would impair full appreciation and understanding of the company's activities and comparison of figures from year to year and with other companies.

Whilst a distinction between "technical" and "non-technical" results would be helpful in identifying the elements comprising the results of trading, it does not seem appropriate to recommend a specific clarification of these terms given the problems of definition involved.

The separate disclosure of the amounts of bonuses to policyholders may be useful to the correct understanding of the operating results of insurance companies. Any specific clarification would need to address itself to a definition of what is meant to be included under this heading. The inclusion of partial refunds of premiums under certain types of general insurance business policies on the grounds that these are equivalent to bonuses raises problems of definition and is contrary to present practice. The allocation of profit by way of bonuses to policyholders under life insurance contracts can take many forms and it would, for example, be necessary to distinguish between bonuses allocated in accordance with a vested right of the policyholder and bonuses which only become payable in the event of death before the maturity date of the policy.

In the light of the above considerations it is suggested that the existing general clarifications of the term "operating results" should be regarded as applicable to insurance companies and that there is no need for a specific clarification. In a separate report which is based on a detailed survey of actual accounting and reporting practices by insurance companies, suggestions are made to increase international comparability in this area[8].

ix) Segmentation of information

Under the Guidelines, the type of segmented information to be disclosed is described as follows:

"...

iii) The operating results and sales by geographical area and the sales in the major lines of business for the enterprise as a whole;

iv) Significant new capital investment by geographical area and, as far as practicable, by major lines of business for the enterprise as a whole;

v) ....

vi) The average number of employees in each geographical area."

While the general clarification of "major lines of business" is broadly applicable to insurance companies consideration should be given to the most appropriate form of "line of business reporting". This might, for example, be to simply distinguish between life and non-life insurance activities. An additional approach could be to distinguish between short and longer-term risks in non-life insurance.

Concerning "geographical areas" the general clarification refers to the definition provided in the footnote to item *ii)* of the chapter on disclosure of information of the Guidelines which reads:

"For the purposes of the guideline on disclosure of information the term 'geographical area' means groups of countries or individual countries as each enterprise determines is appropriate in its particular circumstances. While no single method of grouping is appropriate for all enterprise or for all purposes, the factors to be considered by an enterprise would include the significance of operations carried out in individual countries

or areas as well as the effects on its competitiveness, geographic proximity, economic affinity, similarities in business environments and the nature, scale and degree of interrelationship of the enterprise's operations in the various countries."

While this definition is generally applicable for insurance companies, it should be noted that for insurance purposes there are two alternatives to determine geographical areas "where operations are carried out": the location of the risk and the location of the insured. In addition, for certain classes and categories of business (e.g. marine and aviation insurance), it is often impossible to relate the business to a particular geographic area. In the United Kingdom, for example, it is common practice to regard marine, aviation and transport business as well as reinsurance business accepted in the United Kingdom as United Kingdom business or alternatively to simply disclose such business without any attempt to attribute it to a particular geographical area. Given these difficulties and divergencies in practices, insurance companies should indicate, in the notes to their accounts, the criteria used for determining geographical areas for reporting purposes and the method followed for allocating business to these areas.

2. Specific clarifications with respect to insurance companies

i) Sales

In considering this item it is necessary to identify what corresponds to the term "sales" in the insurance business. While this term is not generally used by insurance companies, reasonable equivalents can be found.

ii) Premium income

For insurance business (life and non-life), premium income is a reflection of the volume of services provided in a given year and can be regarded as the nearest equivalent to sales in a manufacturing environment. Premium income is, however, not the only indicator of activity – the return on investments is particularly relevant in this context.

iii) Investment return

This comprises investment income together with realised and unrealised investment gains and losses. In considering current practices it is necessary to deal separately with the treatment of investment income on the one hand and the treatment of realised and unrealised investment gains and losses on the other, notwithstanding that both are constituent elements of the total investment return.

a) *Investment income*: This is normally disclosed separately in the income statement either gross or net of related expenses. In certain countries, it is common practice to allocate part of the total investment income to the general insurance revenue account to determine a "technical" result. Investment income relating to life insurance business is normally included in full in the life insurance revenue account;
b) *Realised and unrealised investment gains and losses*: Current practices vary considerably in Member countries. Realised gains and losses are sometimes reflected as a separate item in the income statement. Unrealised gains and losses are only reflected in the financial statements when investments are stated at current values. In this event they are normally treated as a movement on reserves. A recent

development is to include in the income statement an amount described as "investment return" reflecting investment income and a proportion of realised and unrealised gains and losses based on the average of the current and previous years with an adjustment to transfer to reserves the element of unrealised gains and losses included in the total.

Premium income seems an appropriate equivalent to sales as an indicator of the level of activity of an insurance enterprise. Information should be given with regard to both gross and net premium income. Disclosure of gross premiums has the advantage of providing more complete information because it reflects the level of activity before outgoing reinsurance. The amount of premium income to be disclosed may be either written or earned premiums, provided that the basis is indicated.

It is debatable whether investment income should be aggregated with premium income to show a combined figure to represent the equivalent of sales for the purpose of the guidelines. It is suggested that the proposed clarification of the term "sales" should be confined to premium income and that investment income should be disclosed separately showing both gross and net amounts.

It would be desirable if investment gains and losses were separately disclosed without set-off and with a distinction made between realised and unrealised gains and losses where both are recognised in the accounts. However, the wide divergence of national practices in this area poses problems which it is suggested cannot be resolved in the context of a clarification for the purpose of the Guidelines. Therefore, in the interest of improved comparability, insurance companies should indicate in the notes to their financial statements the accounting treatment they apply to realised and unrealised investment gains and losses.

In the light of the foregoing, the following disclosure by insurance companies is considered to be equivalent to "sales" under item *iii)* of the chapter on disclosure of information of the Guidelines:

"For insurance companies premium income should be disclosed on both a gross and net of reinsurance basis with an indication as to whether this represents written or earned premiums. In addition, investment income should be separately disclosed either gross or net of related expenses. Any amounts netted against gross premiums or investment income should be disclosed in the notes to the financial statements."

Annex

THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES

In the preceding clarifications frequent reference is made to the introduction chapter of the Guidelines and to the chapter on disclosure of information. These chapters are reproduced below[9].

A. INTRODUCTORY CHAPTER OF THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES

1. Multinational enterprises now play an important part in the economies of Member countries and in international economic relations, which is of increasing interest to governments. Through international direct investment, such enterprises can bring substantial benefits to home and host countries by contributing to the efficient utilisation of capital, technology and human resources between countries and can thus fulfil an important role in the promotion of economic and social welfare. But the advances made by multinational enterprises in organising their operations beyond the national framework may lead to abuse of concentrations of economic power and to conflicts with national policy objectives. In addition, the complexity of these multinational enterprises and the difficulty of clearly perceiving their diverse structures, operations and policies sometimes give rise to concern.

2. The common aim of the Member countries is to encourage the positive contributions which multinational enterprises can make to economic and social progress and to minimise and resolve the difficulties to which their various operations may give rise. In view of the transnational structure of such enterprises, this aim will be furthered by co-operation among the OECD countries where the headquarters of most of the multinational enterprises are established and which are the location of a substantial part of their operations. The Guidelines set out hereafter are designed to assist in the achievement of this common aim and to contribute to improving the foreign investment climate.

3. Since the operations of multinational enterprises extend throughout the world, including countries that are not Members of the Organisation, international co-operation in this field should extend to all States. Member countries will give their full support to efforts undertaken in co-operation with non-member countries, and in particular with developing countries, with a view to improving the welfare and living standards of all people both by encouraging the positive contributions which multinational enterprises can make and by minimising and resolving the problems which may arise in connection with their activities.

4. Within the Organisation, the programme of co-operation to attain these ends will be a continuing, pragmatic and balanced one. It comes within the general aims of the Convention on the Organisation for

Economic Co-operation and Development (OECD) and makes full use of the various specialised bodies of the Organisation, whose terms of reference already cover many aspects of the role of multinational enterprises, notably in matters of international trade and payments, competition, taxation, manpower, industrial development, science and technology. In these bodies, work is being carried out on the identification of issues, the improvement of relevant qualitative and statistical information and the elaboration of proposals for action designed to strengthen inter-governmental co-operation. In some of these areas procedures already exist through which issues related to the operations of multinational enterprises can be taken up. This work could result in the conclusion of further and complementary agreements and arrangements between governments.

5. The initial phase of the co-operation programme is composed of a Declaration and three Decisions promulgated simultaneously as they are complementary and inter-connected, in respect of Guidelines for multinational enterprises, National Treatment for foreign-controlled enterprises and international investment incentives and disincentives.

6. The Guidelines set out below are recommendations jointly addressed by Member countries to multinational enterprises operating in their territories. These Guidelines, which take into account the problems which can arise because of the international structure of these enterprises, lay down standards for the activities of these enterprises in the different Member countries. Observance of the Guidelines is voluntary and not legally enforceable. However, they should help to ensure that the operations of these enterprises are in harmony with national policies of the countries where they operate and to strengthen the basis of mutual confidence between enterprises and States.

7. Every State has the right to prescribe the conditions under which multinational enterprises operate within its national jurisdiction, subject to international law and to the international agreements to which it has subscribed. The entities of a multinational enterprise located in various countries are subject to the laws of these countries.

8. A precise legal definition of multinational enterprises is not required for the purposes of the Guidelines. These usually comprise companies or other entities whose ownership is private, state or mixed, established in different countries and so linked that one or more of them may be able to exercise a significant influence over the activities of others and, in particular, to share knowledge and resources with the others. The degree of autonomy of each entity in relation to the others varies widely from one multinational enterprise to another, depending on the nature of the links between such entities and the fields of activity concerned. For these reasons, the Guidelines are addressed to the various entities within the multinational enterprise (parent companies and/or local entities) according to the actual distribution of responsibilities among them on the understanding that they will co-operate and provide assistance to one another as necessary to facilitate observance of the Guidelines. The word "enterprise" as used in these Guidelines refers to these various entities in accordance with their responsibilities.

9. The Guidelines are not aimed at introducing differences of treatment between multinational and domestic enterprises; wherever relevant they reflect good practice for all. Accordingly, multinational and domestic enterprises are subject to the same expectations in respect of their conduct wherever the Guidelines are relevant to both.

10. The use of appropriate international dispute settlement mechanisms, including arbitration, should be encouraged as a means of facilitating the resolution of problems arising between enterprises and Member countries.

11. Member countries have agreed to establish appropriate review and consultation procedures concerning issues arising in respect of the Guidelines. When multinational enterprises are made subject to conflicting requirements by Member countries, the governments concerned will co-operate in good faith with a view to resolving such problems either within the Committee on International Investment and Multinational Enterprises established by the OECD Council on 21st January 1975 or through other mutually acceptable arrangements.

Having regard to the foregoing considerations, the Member countries set forth the following Guidelines for multinational enterprises with the understanding that Member countries will fulfil their responsibilities to treat enterprises equitably and in accordance with international law and international agreements, as well as contractual obligations to which they have subscribed.

B. CHAPTER ON DISCLOSURE OF INFORMATION OF THE GUIDELINES FOR MULTINATIONAL ENTERPRISES

Enterprises should, having due regard to their nature and relative size in the economic context of their operations and to requirements of business confidentiality and to cost, publish in a form suited to improve public understanding a sufficient body of factual information on the structure, activities and policies of the enterprise as a whole, as a supplement, in so far as necessary for this purpose, to information to be disclosed under the national law of the individual countries in which they operate. To this end, they should publish within reasonable time limits, on a regular basis, but at least annually, financial statements and other pertinent information relating to the enterprise as a whole, comprising in particular:

i) The structure of the enterprise, showing the name and location of the parent company, its main affiliates, its percentage ownership, direct and indirect, in these affiliates, including shareholdings between them;

ii) The geographical areas (*) where operations are carried out and the principal activities carried on therein by the parent company and the main affiliates;

iii) The operating results and sales by geographical area and the sales in the major lines of business for the enterprise as a whole;

iv) Significant new capital investment by geographical area and, as far as practicable, by major lines of business for the enterprise as a whole;

v) A statement of the sources and uses of funds by the enterprise as a whole;

vi) The average number of employees in each geographical area;

vii) Research and development expenditure for the enterprise as a whole;

viii) The policies followed in respect of intra-group pricing;

ix) The accounting policies, including those on consolidation, observed in compiling the published information.

* *For the purposes of the Guideline on Disclosure of Information the term "geographical area" means groups of countries or individual countries as each enterprise determines is appropriate in its particular circumstances. While no single method of grouping is appropriate for all enterprises or for all purposes, the factors to be considered by an enterprise would include the significance of operations carried out in individual countries or areas as well as the effects on its competitiveness, geographic proximity, economic affinity, similarities in business environments and the nature, scale and degree of interrelationship of the enterprises' operations in the various countries.*

NOTES AND REFERENCES

1. Following a reorganisation of the European accounting profession, the Groupe d'Etudes has been replaced by the Fédération des Experts-Comptables Européens (FEE).
2. *Harmonization of Accounting Standards – Achievements and Perspectives*, OECD, 1986.
3. I. *Accounting Standards Harmonization – No.1 Foreign Currency Translation*, OECD, 1986; *Accounting Standards Harmonization – No.2 Consolidation Policies in OECD Countries*, OECD, 1987; *Accounting Standards Harmonization – No.3 The Relationship Between Taxation and Financial Reporting – Income tax Accounting*, OECD, 1987.

   II. Working Papers by the Working Group on Accounting Standards:

   No.1: "Accounting Treatment of Software", OECD, 1986.
   No.2: "Availability of Financial Statements", OECD, 1987.
   No.3: "Disclosure of Information by Multinational Enterprises – Survey of the Application of the OECD Guidelines", OECD, 1987.
   No.4: "Accounting for Leases", OECD, 1988.
   No.5: "Qualification of Auditors", OECD, 1988.
4. See the reports on *Foreign Currency Translation, The Relationship Between Taxation and Financial Reporting – Income tax Accounting*, precited.
5. See, *Foreign Currency Translation*, OECD, 1986, paragraphs 32 *et seq.*
6. The Working Group has set up a technical subgroup to study accounting for leases. A report is expected to be published in 1989.
7. Reference is also made to the definition of research and experimental development recommended for statistical purposes in the 1980 OECD Manual on the *Measurement of Scientific and Technical Activities* which in paragraph 43 reads as follows: "Research and experimental development (R & D) comprise creative work undertaken on a systematic basis in order to increase the stock of knowledge, including knowledge of man, culture and society and the use of this stock of knowledge to devise new applications". Paragraphs 44 to 77 of that document set forth detailed explanations of these terms.
8. See, *Accounting Standards Harmonization – No. 4 Accounting and Reporting by Insurance Companies* (forthcoming).
9. For a complete description of the Guidelines (text and commentaries) reference is made to: *The OECD Guidelines for Multinational Enterprises*, OECD, 1984.