20 Financial Applications

Accounting can be complicated for firms conducting business globally and for multinational companies. While there are generally accepted accounting principles (GAAP) in the United States, there are different accounting principles in Europe and Asia and even differences between countries on the same continent. Earnings per share for one company do not necessarily equate to earnings per share for a similar company in another country.

For example, the Japanese are known to have very conservative accounting practices that result in low earnings when compared to American counterparts. Japanese companies do not have to report all income as income; they may reserve some income for contingencies and this avoid reporting taxable income. This relatively low income causes Japanese firms to have higher price to earnings ratios than U.S. companies, and investors who compare such ratios often jump to the incorrect conclusion that Japanese stock prices are too high.

German companies have similar conservative accounting practices, so when German companies list shares on the New York Stock Exchange, the accounting statements have to conform to U.S. GAAP. German companies may report more in cash in the U.S. than in Germany because Germany does not require disclosure of some reserve accounts.

There are many ways that accounting statements can differ across countries. The major differences are in the areas of depreciation, inventory, reserve accounting, expense reporting, and amortization of goodwill. Some countries allow faster depreciation of equipment, which results in higher expenses and lower income. Goodwill is treated differently in the United States than in many other countries, which means expenses will differ. The differences between countries' expense procedures can account for most of the differences in income and earnings per share. The moral of the story is that when making performance comparisons among international firms, statements may have to be adjusted for accounting differences.