## Contents

### About the Authors  iv

### Preface  v

### Chapter 1

**Introduction to International Accounting  1**

- What Is International Accounting?  1
- Evolution of a Multinational Corporation  2
  - Sales to Foreign Customers  2
  - Hedges of Foreign Exchange Risk  4
  - Foreign Direct Investment  4
  - Financial Reporting for Foreign Operations  6
  - International Income Taxation  7
  - International Transfer Pricing  7
  - Performance Evaluation of Foreign Operations  8
  - International Auditing  8
  - Cross-Listing on Foreign Stock Exchanges  9
  - International Harmonization of Accounting Standards  10

- The Global Economy  10
  - International Trade  10
  - Foreign Direct Investment  11
  - Multinational Corporations  12
  - International Capital Markets  14

- Outline of the Book  14

- Summary  15

- Questions  16

- Exercises and Problems  16

- Case 1-1: Besserbrau AG  18

- Case 1-2: Vanguard International Growth Fund  19

- Case 1-3: Nestlé Group  21

- References  25

### Chapter 2

**Worldwide Accounting Diversity  26**

- Introduction  26

- Evidence of Accounting Diversity  27

- Reasons for Accounting Diversity  31
  - Legal System  32
  - Taxation  33
  - Providers of Financing  33
  - Inflation  34
  - Political and Economic Ties  34
  - Correlation of Factors  34

- Problems Caused by Accounting Diversity  35
  - Preparation of Consolidated Financial Statements  35
  - Access to Foreign Capital Markets  35
  - Comparability of Financial Statements  35
  - Lack of High-Quality Accounting Information  36

- Accounting Clusters  37
  - A Judgmental Classification of Financial Reporting Systems  38
  - An Empirical Test of the Judgmental Classification  39

- The Influence of Culture on Financial Reporting  40
  - Hofstede's Cultural Dimensions  40
  - Gray's Accounting Values  41
  - Religion and Accounting  43

- A Simplified Model of the Reasons for International Differences in Financial Reporting  44
  - Examples of Countries with Class A Accounting  45
  - Recent Changes in Europe  46

- Further Evidence of Accounting Diversity  46
  - Financial Statements  46
  - Format of Financial Statements  47
  - Level of Detail  50
  - Terminology  52
  - Disclosure  52
  - Recognition and Measurement  57

- Summary  59

- Appendix to Chapter 2

- The Case of Daimler-Benz  60

- Questions  62

- Exercises and Problems  63

- Case 2-1: The Impact of Culture on Conservatism  65

- Case 2-2: SKD Limited  66

- References  68
Chapter 3
International Convergence of Financial Reporting 69

Introduction 69
Harmonization and Convergence 70
Arguments for and against Harmonization 71
  Arguments for Harmonization 71
  Arguments against Harmonization 72
Major Harmonization Efforts 72
  International Organization of Securities Commissions 72
  International Federation of Accountants 73
  European Union 74
The International Accounting Standards Committee 76
  The “Lowest-Common-Denominator” Approach 77
  The Comparability Project 77
  TheIOSCO Agreement 77
  U.S. Reaction to International Accounting Standards 78
  Compliance with International Accounting Standards 79
Creation of the IASB 80
  The Structure of the IASB 80
The IASB Framework 84
  The Need for Framework 84
  Objective of Financial Statements and Underlying Assumptions 85
  Qualitative Characteristics of Financial Statements 85
  Elements of Financial Statements: Definition, Recognition, and Measurement 86
  Concepts of Capital Maintenance 86
  Revision of IASB Framework 86
International Financial Reporting Standards 88
A Principles-Based Approach to International Financial Reporting Standards 91
Presentation of Financial Statements (IAS 1) 92
First-Time Adoption of International Financial Reporting Standards (IFRS 1) 93
International Convergence 96
The Adoption of International Financial Reporting Standards 97
IFRS in the European Union 100
IFRS in the United States 101
  Support for a Principles-Based Approach 101
  The Norwalk Agreement 102
  Change of SEC Policy toward IFRS 103
Some Concluding Remarks 104
Summary 105

Appendix to Chapter 3
What Is This Thing Called Anglo-Saxon Accounting? 106
Questions 108
Exercises and Problems 109
Case 3-1: Jardine Matheson Group (Part 1) 111
References 112

Chapter 4
International Financial Reporting Standards 114

Introduction 114
Types of Differences between IFRS and U.S. GAAP 115
Recognition and Measurement Standards 116
  IAS 2, Inventories 116
  IAS 16, Property, Plant, and Equipment 118
  IAS 40, Investment Property 124
  IAS 38, Intangible Assets 124
  IAS 36, Impairment of Assets 129
  IAS 23, Borrowing Costs 135
  IAS 17, Leases 135
  Other Recognition and Measurement Standards 138
Disclosure and Presentation Standards 138
Summary 141

Appendix to Chapter 4
Other Recognition and Measurement Standards 142
Questions 153
Exercises and Problems 154
Case 4-1: Jardine Matheson Group (Part 2) 159
References 160

Chapter 5
Comparative Accounting 162

Introduction 162
People’s Republic of China 164
  Background 164
  Accounting Profession 166
  Accounting Regulation 170
  Accounting Principles and Practices 173
Germany 179
  Background 179
  Accounting Profession 180
  Accounting Regulation 180
  Accounting Principles and Practices 183
Japan 195
  Background 195
  Accounting Profession 196
International Financial Reporting Standards 323
The Translation Process Illustrated 325
Translation of Financial Statements: Current Rate Method 326
  Translation of the Balance Sheet 327
  Computation of Translation Adjustment 329
Remeasurement of Financial Statements: Temporal Method 329
  Remeasurement of Income Statement 329
  Computation of Remeasurement Gain 331
Comparison of the Results from Applying the Two Different Methods 332
  Underlying Valuation Method 333
  Underlying Relationships 333
Hedging Balance Sheet Exposure 334
Disclosures Related to Translation 335
Summary 340
Questions 341
Exercises and Problems 342
Case 7-1: Columbia Corporation 349
Case 7-2: Palmerstown Company 351
Case 7-3: BellSouth Corporation 353
References 354

Chapter 8
Additional Financial Reporting Issues 355
Introduction 355
Accounting for Changing Prices (Inflation Accounting) 356
  Impact of Inflation on Financial Statements 356
  Purchasing Power Gains and Losses 357
  Methods of Accounting for Changing Prices 357
  General Purchasing Power (GPP) Accounting 359
  Current Cost (CC) Accounting 360
  Inflation Accounting Internationally 361
  International Financial Reporting Standards 364
  Translation of Foreign Currency Financial Statements in Hyperinflationary Economies 367
Business Combinations and Consolidated Financial Statements 370
  Determination of Control 370
  Scope of Consolidation 373
  Full Consolidation 373
  Proportionate Consolidation 377
  Equity Method 379
Segment Reporting 380
  Operating Segments—The Management Approach 381
  Example: Application of Significance Tests 382
  Operating Segment Disclosures 384
  Entity-Wide Disclosures 385
Summary 388
Questions 390
Exercises and Problems 390
References 398

Chapter 9
Analysis of Foreign Financial Statements 399
Introduction 399
Overview of Financial Analysis 399
Reasons to Analyze Foreign Financial Statements 401
  Foreign Portfolio Investment 401
  International Mergers and Acquisitions 401
  Other Reasons 402
Potential Problems in Analyzing Foreign Financial Statements 402
  Data Accessibility 402
  Language 403
  Currency 405
  Terminology 407
  Format 407
  Extent of Disclosure 408
  Timeliness 411
  Differences in Accounting Principles 412
  International Ratio Analysis 415
Restating Financial Statements 417
  Explanation of Reconciling Adjustments 422
  Comparison of Local GAAP and U.S. GAAP Amounts 427
Summary 428
Appendix to Chapter 9
Morgan Stanley Dean Witter: Apples to Apples 429
Questions 432
Exercises and Problems 432
Case 9-1: Swisscom AG 444
References 448

Chapter 10
International Taxation 449
Introduction 449
  Investment Location Decision 449
  Legal Form of Operation 450
  Method of Financing 450
Types of Taxes and Tax Rates 450
  Income Taxes 450
  Tax Havens 452
  Withholding Taxes 454
  Tax-Planning Strategy 455
  Value-Added Tax 455
Contents xv

Tax Jurisdiction 456
   Worldwide versus Territorial Approach 456
   Source, Citizenship, and Residence 457
   Double Taxation 458

Foreign Tax Credits 459
   Credit versus Deduction 459
   Calculation of Foreign Tax Credit (FTC) 460
   Excess Foreign Tax Credits 461
   FTC Baskets 462
   Indirect Foreign Tax Credit (FTC for Subsidiaries) 463

Tax Treaties 465
   Model Treaties 465
   U.S. Tax Treaties 466
   Treaty Shopping 467

Controlled Foreign Corporations 468
   Subpart F Income 469
   Determination of the Amount of CFC Income Currently Taxable 469
   Safe Harbor Rule 469

Summary of U.S. Tax Treatment of Foreign Source Income 470
   Example: U.S. Taxation of Foreign Source Income 471

Translation of Foreign Operation Income 473
   Translation of Foreign Branch Income 473
   Translation of Foreign Subsidiary Income 474
   Foreign Currency Transactions 475

Tax Incentives 476
   Tax Holidays 476
   U.S. Export Incentives 477

Summary 479

Appendix to Chapter 10
U.S. Taxation of Expatriates 480
Questions 483
Exercises and Problems 484
Case 10-1: U.S. International Corporation 491
References 492

Chapter 11
International Transfer Pricing 493

Introduction 493
Decentralization and Goal Congruence 494
Transfer Pricing Methods 495
Objectives of International Transfer Pricing 496
   Performance Evaluation 496
   Cost Minimization 498
   Other Cost-Minimization Objectives 498
   Survey Results 500
   Interaction of Transfer Pricing Method and Objectives 501

Government Reactions 502
U.S. Transfer Pricing Rules 502
   Sale of Tangible Property 503
   Licenses of Intangible Property 508
   Intercompany Loans 510
   Intercompany Services 511
   Arm's-Length Range 511
   Correlative Relief 511
   Penalties 513
   Contemporaneous Documentation 513
   Reporting Requirements 514

Advance Pricing Agreements 514
Enforcement of Transfer Pricing Regulations 516
   Worldwide Enforcement 517
Summary 518
Questions 519
Exercises and Problems 520
Case 11-1: Litchfield Corporation 525
Case 11-2: Global Electronics Company 526
References 527

Chapter 12
Strategic Accounting Issues in Multinational Corporations 528

Introduction 528
Strategy Formulation 529
   Capital Budgeting 529
   Capital Budgeting Techniques 531
   Multinational Capital Budgeting 534
   Illustration: Global Paper Company 536

Strategy Implementation 542
   Management Control 542
   Operational Budgeting 545

Evaluating the Performance of Foreign Operations 545
   Designing an Effective Performance Evaluation System for a Foreign Subsidiary 547
   Performance Measures 547
   Financial Measures 547
   Nonfinancial Measures 548
   Financial versus Nonfinancial Measures 549
   The Balanced Scorecard: Increased Importance of Nonfinancial Measures 550
   Responsibility Centers 553
   Foreign Operating Unit as a Profit Center 553
   Separating Managerial and Unit Performance 554
   Examples of Uncontrollable Items 555
   Choice of Currency in Measuring Profit 556
   Foreign Currency Translation 557
   Choice of Currency in Operational Budgeting 557

References 527
Chapter 13
Comparative International Auditing and Corporate Governance 581

Introduction 581
International Auditing and Corporate Governance 582
International Diversity in External Auditing 586
Purpose of Auditing 586
Audit Environments 588
Regulation of Auditors and Audit Firms 590
Audit Reports 593
International Harmonization of Auditing Standards 595
Additional International Auditing Issues 600
Auditor's Liability 600
Limiting Auditor's Liability 600

Auditor Independence 602
Audit Committees 606
Internal Auditing 607
The Demand for Internal Auditing in MNCs 609
U.S. Legislation against Foreign Corrupt Practices (FCPA) 609
Legislation in Other Jurisdictions 611
Future Directions 614
Consumer Demand 614
Reporting on the Internet 615
Increased Competition in the Audit Market 615
Continued High Interest in the Audit Market 616
Increased Exposure of the International Auditing Firms 616
Tendency toward a Checklist Approach 616
Auditing No Longer Only the Domain of the External Auditor 616

Summary 616
Appendix to Chapter 13
Examples of Audit Reports from Multinational Corporations 617
Questions 622
Exercises and Problems 623
Case 13-1: Honda Motor Company 624
Case 13-2: Harmonization of the Audit Report and the Big Four 625
References 628