Brief Contents

About the Authors iv
Preface v

Chapter
1 Introduction to International Accounting 1
2 Worldwide Accounting Diversity 23
3 International Convergence of Financial Reporting 65
5 International Financial Reporting Standards: Part II 175
6 Comparative Accounting 233
7 Foreign Currency Transactions and Hedging Foreign Exchange Risk 339
8 Translation of Foreign Currency Financial Statements 403
9 Additional Financial Reporting Issues 449
10 Analysis of Foreign Financial Statements 493
11 International Taxation 543
12 International Transfer Pricing 588
13 Strategic Accounting Issues in Multinational Corporations 623
14 Comparative International Auditing and Corporate Governance 679
15 International Corporate Social Reporting 744
Case 6-1: China Petroleum and Chemical Corporation 330
References 336

Chapter 7
Foreign Currency Transactions and Hedging Foreign Exchange Risk 339

Introduction 339
Foreign Exchange Markets 340
Exchange Rate Mechanisms 340
Foreign Exchange Rates 341
Spot and Forward Rates 343
Option Contracts 344
Foreign Currency Transactions 344
Accounting Issue 345
Accounting Alternatives 345
Balance Sheet Date before Date of Payment 347

Hedging Foreign Exchange Risk 349
Accounting for Derivatives 350
Fundamental Requirement of Derivatives Accounting 351
Determining the Fair Value of Derivatives 351
Accounting for Changes in the Fair Value of Derivatives 352

Hedge Accounting 352
Nature of the Hedged Risk 352
Hedge Effectiveness 353
Hedge Documentation 353

Hedging Combinations 353
Hedges of Foreign-Currency-Denominated Assets and Liabilities 354
Forward Contract Used to Hedge a Recognized Foreign-Currency-Denominated Asset 355
Forward Contract Designated as Cash Flow Hedge 357
Forward Contract Designated as Fair Value Hedge 361

Foreign Currency Option Used to Hedge a Recognized Foreign-Currency-Denominated Asset 363
Option Designated as Cash Flow Hedge 365
Spot Rate Exceeds Strike Price 367
Option Designated as Fair Value Hedge 368

Hedges of Unrecognized Foreign Currency Firm Commitments 368
Forward Contract Used as Fair Value Hedge of a Firm Commitment 368
Option Used as Fair Value Hedge of Firm Commitment 371

Hedge of Forecasted Foreign-Currency-Denominated Transaction 373
Option Designated as a Cash Flow Hedge of a Forecasted Transaction 374

Use of Hedging Instruments 375
The Euro 377
Foreign Currency Borrowing 377
Foreign Currency Loan 379

Summary 379

Appendix to Chapter 7
Illustration of the Accounting for Foreign Currency Transactions and Hedging Activities by an Importer 380

Questions 392
Exercises and Problems 393
Case 7-1: Zorba Company 401
Case 7-2: Portofino Company 402
Case 7-3: Better Food Corporation 402
References 402

Chapter 8
Translation of Foreign Currency Financial Statements 403

Introduction 403
Two Conceptual Issues 404
Example 404
Balance Sheet Exposure 407

Translation Methods 408
Current/Noncurrent Method 408
Monetary/Nonmonetary Method 408
Temporal Method 409
Current Rate Method 410
Translation of Retained Earnings 411
Complicating Aspects of the Temporal Method 413

Disposition of Translation Adjustment 414

U.S.GAAP 415
FASBASC830 416
Functional Currency 416
Highly Inflationary Economies 417

International Financial Reporting Standards 418
The Translation Process Illustrated 420
Translation of Financial Statements: Current Rate Method 421
Translation of the Balance Sheet: Current Rate Method 422
Computation of Translation Adjustment 424

Remeasurement of Financial Statements: Temporal Method 424
Remeasurement of Income Statement 424
Computation of Remeasurement Gain 426

Comparison of the Results from Applying the Two Different Methods 427
Underlying Valuation Method 428
Underlying Relationships 428

Hedging Balance Sheet Exposure 429
Disclosures Related to Translation 430
Chapter 9
Additional Financial Reporting

Introduction 449
Accounting for Changing Prices (Inflation Accounting) 450
Impact of Inflation on Financial Statements 450
Purchasing Power Gains and Losses 451
Methods of Accounting for Changing Prices 451
General Purchasing Power (GPP) Accounting 453
Current Cost (CC) Accounting 454
Inflation Accounting Internationally 455
International Financial Reporting Standards 458
Translation of Foreign Currency Financial Statements in Hyperinflationary Economies 461

Business Combinations and Consolidated Financial Statements 464
Determination of Control 465
Scope of Consolidation 468
Proportionate Consolidation 472
Equity Method 473

Segment Reporting 475
Operating Segments—The Management Approach 476
Example: Application of Significance Tests 477
Operating Segment Disclosures 478
Entity-Wide Disclosures 479

Summary 483
Questions 484
Exercises and Problems 484
References 492

Chapter 10
Analysis of Foreign Financial Statements 493
Introduction 493
Overview of Financial Statement Analysis 493
Reasons to Analyze Foreign Financial Statements 495
Foreign Portfolio Investment 495
International Mergers and Acquisitions 495
Other Reasons 496

Potential Problems in Analyzing Foreign Financial Statements 496
Data Accessibility 496
Language 497
Currency 498
Terminology 500
Format 501
Extent of Disclosure 501
Timeliness 504
Differences in Accounting Principles 505
International Ratio Analysis 508

Restating Financial Statements 510
Explanation of Reconciling Adjustments 515
Comparison of Local GAAP and U.S. GAAP Amounts 520

Summary 521

Appendix to Chapter 10
Morgan Stanley Dean Witter: Apples to Apples 522

Questions 525
Exercises and Problems 525
Case 10-1: Swisscom AG 537
References 541

Chapter 11
International Taxation 543
Introduction 543
Investment Location Decision 543
Legal Form of Operation 544
Method of Financing 544
Types of Taxes and Tax Rates 544
Income Taxes 544
Tax Havens 546
Withholding Taxes 548
Tax-Planning Strategy 549
Value-Added Tax 549

Tax Jurisdiction 550
Worldwide versus Territorial Approach 550
Source, Citizenship, and Residence 551
Double Taxation 552

Foreign Tax Credits 553
Credit versus Deduction 553
Calculation of Foreign Tax Credit 554
Excess Foreign Tax Credits 555
FTC Baskets 557
Indirect Foreign Tax Credit (FTC for Subsidiaries) 558

Tax Treaties 559
   Model Treaties 560
   U.S. Tax Treaties 560
   Treaty Shopping 562

Controlled Foreign Corporations 563
   Subpart F Income 563
   Determination of the Amount of CFC Income Currently
   Taxable 564
   Safe Harbor Rule 564

Summary of U.S. Tax Treatment of Foreign
Source Income 564
   Example: U.S. Taxation of Foreign Source Income 564

Translation of Foreign Operation Income 567
   Translation of Foreign Branch Income 568
   Translation of Foreign Subsidiary Income 569
   Foreign Currency Transactions 570

Tax Incentives 570
   Tax Holidays 571
   U.S. Export Incentives 572

Appendix to Chapter 11
U.S. Taxation of Expatriates 575
   Questions 578
   Exercises and Problems 578
   Case 11-1: U.S. International Corporation 586
   References 587

Chapter 12
International Transfer Pricing 588

   Introduction 588
   Decentralization and Goal Congruence 589
   Transfer Pricing Methods 590
   Objectives of International Transfer Pricing 591
      Performance Evaluation 591
      Cost Minimization 593
      Other Cost-Minimization Objectives 593
      Survey Results 595
      Interaction of Transfer Pricing Method and
      Objectives 596
   Government Reactions 597
   U.S. Transfer Pricing Rules 597
      Sale of Tangible Property 598
      Licenses of Intangible Property 603
      Intercompany Loans 605
      Intercompany Services 606
      Arm's-Length Range 606
      Correlative Relief 606
      Penalties 608

Contemporaneous Documentation 608
   Reporting Requirements 609
   Advance Pricing Agreements 609
   Enforcement of Transfer Pricing
   Regulations 611
   Worldwide Enforcement 612
   Summary 613
   Questions 614
   Exercises and Problems 615
   Case 12-1: Litchfield Corporation 620
   Case 12-2: Global Electronics Company 621
   References 622

Chapter 13
Strategic Accounting Issues in
Multinational Corporations 623

   Introduction 623
   Strategy Formulation 624
      Capital Budgeting 627
      Capital Budgeting Techniques 628
      Multinational Capital Budgeting 631
      Illustration: Global Paper Company 633
   Strategy Implementation 639
      Management Control 639
      Operational Budgeting 642
   Evaluating the Performance of Foreign
   Operations 642
      Designing an Effective Performance Evaluation System
      for a Foreign Subsidiary 644
      Performance Measures 644
      Financial Measures 644
      Nonfinancial Measures 645
      Financial versus Nonfinancial Measures 646
      The Balanced Scorecard: Increased Importance of
      Nonfinancial Measures 647
      Responsibility Centers 650
      Foreign Operating Unit as a Profit Center 650
      Separating Managerial and Unit Performance 651
      Examples of Uncontrollable Items 652
      Choice of Currency in Measuring Profit 653
      Foreign Currency Translation 654
      Choice of Currency in Operational Budgeting 655
      Incorporating Economic Exposure into the Budget
      Process 658
   Implementing a Performance Evaluation System 661
   Culture and Management Control 662
   Summary 663
   Questions 665
   Exercises and Problems 665
   Case 13-1: Canyon Power Company 667
Case 13-2: Lion Nathan Limited 669
References 676

Chapter 14
Comparative International Auditing and Corporate Governance 679

Introduction 679
International Auditing and Corporate Governance 681
International Diversity in External Auditing 685

Purpose of Auditing 685
Audit Environments 687
Regulation of Auditors and Audit Firms 689
Audit Reports 692

International Harmonization of Auditing Standards 694
Ethics and International Auditing 699

A More Communitarian View of Professional Ethics 700

Additional International Auditing Issues 700

Auditor’s Liability 700
Limiting Auditor’s Liability 701
Auditor Independence 703
Audit Committees 706

Internal Auditing 708

The Demand for Internal Auditing in MNCs 710
U.S. Legislation against Foreign Corrupt Practices 710
Legislation in Other Jurisdictions 714

Future Directions 716

Consumer Demand 717
Reporting on the Internet 717

Increased Competition in the Audit Market 718
Continued High Interest in the Audit Market 718

Increased Exposure of the International Auditing Firms 718
Tendency toward a Checklist Approach 719
Auditing No Longer Only the Domain of the External Auditor 719
Different Corporate Governance Models 719

Summary 719

Appendix to Chapter 14
Examples of 2009 Audit Reports from Multinational Corporations 720

Questions 728
Exercises and Problems 728
Case 14-1: Honda Motor Company 730
Case 14-2: Daimler AG 737
References 742

Chapter 15
International Corporate Social Reporting 744

Introduction 744
Theories to Explain CSR Practices 746
Drivers of CSR Practices by Companies 746

Implications of Climate Change for CSR 748

Climate Change at a Glance 748
Some Related Key Concepts 749

Regulating CSR Practices 750

Regulation of CSR in the United States 751
International Arrangements to Regulate CSR 752

Global Reporting Initiative (GRI) 753
CSR Practices by MNCs 758
Concluding Remarks 768
Summary 769
Questions 770
Exercises and Problems 770
References 770
Index 773