CHAPTER 1

Introduction

Accounting plays a vital role in society. As a branch of economics, it provides information about a firm and its transactions to facilitate resource allocation decisions by users of that information. If the information reported is reliable and useful, scarce resources are allocated in an optimal fashion, and conversely, resource allocations are less than optimal when information is less reliable and useful.

International accounting, the subject of this text, is no different in its intended role. What makes its study distinctive is that the entity being reported on is either a multinational company (MNC) with operations and transactions that cross national boundaries, or an entity with reporting obligations to users who are located in a country other than that of the reporting entity.

Recall that accounting entails several broad processes: measurement, disclosure, and auditing. Measurement is the process of identifying, categorizing, and quantifying economic activities or transactions. These measurements provide insights into the profitability of a firm's operations and the strength of its financial position. Disclosure is the process by which accounting measurements are communicated to their intended users. This area focuses on issues such as what is to be reported, when, by what means, and to whom. Auditing is the process by which specialized accounting professionals (auditors) attest to the reliability of the measurement and communication process. Whereas internal auditors are company employees who answer to management, external auditors are nonemployees who are responsible for attesting that the company's financial statements are prepared in accordance with generally accepted standards.

An understanding of the international dimensions of the accounting processes that were just described is important to those engaged in importing or exporting activities, as well as those seeking to manage a business, or obtain or supply financing across national borders. Even a company operating solely within the confines of a single country is no longer insulated from the international aspects of accounting as reliance on international vendors to contain production costs and remain globally competitive is a common feature of contemporary business. Accounting amounts may vary significantly according to the principles that govern them. Differences in culture, business practices, political and regulatory structures, legal systems, currency values, local inflation rates, business risks, and tax codes all affect how the MNC conducts its operations and financial reporting around the world. Financial statements and other disclosures are impossible to understand without an awareness of the underlying accounting principles and business culture.

The importance of studying international accounting has grown over the years. We begin with a brief history of this subject.

HISTORICAL PERSPECTIVE

The history of accounting is an international history. The following chronology demonstrates that accounting has been remarkably successful in its ability to be transplanted from one national setting to another while allowing for continued development in theory and practice worldwide.

To begin, double-entry bookkeeping, generally thought of as the genesis of accounting as we know it today, emanated from the Italian city states of the 14th and 15th centuries. Its development was spurred by the growth of international commerce in northern Italy during the late Middle Ages and the desire of government to find ways to tax commercial transactions. "Bookkeeping in the Italian fashion" then migrated to Germany to assist the merchants of the Fugger era and the Hanseatic league. At about the same time, business philosophers in the Netherlands sharpened ways of calculating periodic income, and government officials in France found it advantageous to apply the whole system to governmental planning and accountability.

In due course, double-entry accounting ideas reached the British Isles. The development of the British Empire created unprecedented needs for British commercial interests to manage and control enterprises in the colonies, and for the records of their colonial enterprises to be reviewed and verified. These needs led to the emergence of accounting societies in the 1850s and an organized public accounting profession in Scotland and England during the 1870s. British accounting practices spread not only throughout North America but also throughout the British Commonwealth as it then existed.

Parallel developments occurred elsewhere. The Dutch accounting model was exported to Indonesia, among other places. The French accounting system found a home in Polynesia and French-administered territories in Africa while the reporting framework of the Germans proved influential in Japan, Sweden, and czarist Russia.

As the economic might of the United States grew during the first half of the 20th century, its sophistication in matters of accounting grew in tandem. Business schools assisted in this development by conceptualizing the subject matter and eventually having it recognized as an academic discipline in its own right on college and university campuses. After World War II, U.S. accounting influence made itself felt throughout the Western world, particularly in Germany and Japan. To a lesser extent, similar factors are directly observable in countries like Brazil, Israel, Mexico, the Philippines, Sweden, and Taiwan.

Despite this international heritage, in most countries accounting remained a nationalistic affair, with national standards and practices deeply anchored into national laws and professional regulations. (Examples of comparative accounting practices are provided in Chapters 3 and 4.) There was little understanding of parallel requirements in other countries. Yet, accounting increasingly serveed people and organizations whose decisions were increasingly international in scope.

Resolving the historical paradox of accounting has long been a concern of both users and preparers of accounting information. In recent years, institutional efforts to narrow differences in measurement, disclosure, and auditing processes around the world have intensified. A description of this effort and the major players with an important stake in attaining convergence of global accounting systems is the focus of Chapter 8.

CONTEMPORARY PERSPECTIVE

While the effort to reduce international accounting diversity is important in its own right, there are today a number of additional factors that are contributing to the growing importance of studying international accounting. These factors stem from significant and continuing reductions in national trade barriers and capital controls together with advances in information technology.

National controls on capital flows, foreign exchange, foreign direct investment, and related transactions have been dramatically liberalized in recent years, reducing the barriers to international business. Changes in financial sector policy in both developed and developing countries reflect the growing realization that information and financial technolgy render capital controls ineffective. National governments also realize that financial market liberaliztion affords them access to international funds with which to finance national debts. As accounting is the language of business, cross-border economic interactions mean that accounting reports prepared in one country must increasingly be used and understood by users in another.

Advances in information technology are also causing a radical change in the economics of production and distribution. Vertically integrated production is no longer proving an efficient mode of operation. Real-time global information linkages mean that production, including accounting services, is increasingly being outsourced, or *offshored*, to whomever in the world can do the job, or portions of the job, best.[1] Leading locations for offshore services today include Argentina, Brazil, Canada, Chile, Costs Rica, Mexico, and Panama in the Americas; Australia, China, India, Malaysia, New Zealand, Pakistan, the Philippines, Singapore, Thailand, and Vietnam in Asia Pacific; and the Czech Republic, Egypt, Hungary, Ireland, Israel, Morocco, Poland, Romania, Russia, Slovakia, South Africa, Spain and the Ukraine in Europe, the Middle East, and Africa.[2] Adversarial, arm's-length relationships that have characterized companies' relations with their suppliers, middle persons, and customers are being replaced by cooperative global linkages with suppliers, suppliers' suppliers, middle persons, customers, and customers' customers.

Exhibit 1-1 provides an illustration of the outsourcing phenomenon. In producing the ProLiant ML150, a small box that helps companies manage customer databases and run e-mail systems, among other things, Hewlett-Packard (H-P) turned to the usual sources of low-cost labor: China and India. However, it also decided to make some ML150s in higher-cost locations such as Singapore and Australia, which were closer to targeted customers. Initial design for the ML150 was done in Singapore and then handed off to an outside contractor in Taiwan. Although China possesses the lowest wage rates, it is but one part of a highly specialized manufacturing system.

[1] For example, see Arie Lewin, Silvia Massini, and Carine Peters, "Why Are Companies Offshoring Innovation? The Emerging Global Race for Talent," *Journal of International Business Studies* 40 (2009): 901–925.
[2] Robert Kennedy, "The Tough Game You Have to Play," *Financial Executive*, May 2009, pp. 23–25.

EXHIBIT 1-1 Outsourcing Process for Hewlett-Packard's ProLiant 150

India	←			
5				
China	←	Taiwan		
5		4		
Australia	←	↓↑		
5		Singapore	→	Houston
		5 3 1	←	2

H-P's Path to Market

1. Idea for ML150 spawned in Singapore
2. Concept approved in Houston
3. Concept design performed in Singapore
4. Engineering design and initial manufacture in Taiwan
5. Final assembly in Australia, China, India, and Singapore. Machines produced in Australia, China, and India sold in local markets; machines assembled in Singapore marketed to Southeast Asia.

Considerations ranging from logistics to tariff policies reportedly kept H-P from putting all of its production lines in China. It would take too long for machines manufactured in China to reach customers in other Asian markets. Moreover, shipping goods to India triggered steep tariffs, so it made sense to produce some ML150s in India with imported parts for the local market. All of the links in this outsourcing example are associated with accounting issues discussed in the following pages of this chapter.

Spurred by the twin developments we have just described, there are several factors that are contributing to the growing importance of the subject matter of this text. We describe each in turn.

GROWTH AND SPREAD OF MULTINATIONAL OPERATIONS

International business has traditionally been associated with foreign trade. This activity, rooted in antiquity, continues unabated. While trade in services has traditionally paled in comparison to trade in merchandise, the former is gaining in significance and growing at a faster rate than the latter. Current trends in exports and imports of both goods and services by region and selected economy are depicted in Exhibit 1-2.

What is not shown in Exhibit 1-2 is the composition of each region's exports and imports. To obtain a better picture of the pattern of global trade at the micro level, one could examine the foreign operations disclosures of any major MNC. Exhibit 1-3 contains the geographic distribution of sales of AKZO Nobel, a multinational company headquartered in the Netherlands and concentrating on healthcare products, coatings, and chemicals. As can be seen, the company's sales literally blanket every continent in the world. Unisys, the U.S.-based information technology services company, provides its expertise to clients in over 100 countries, while

EXHIBIT 1-2 **World Trade by Region**

Total Merchandise Trade — **Unit: U.S. dollar at current prices (millions)**

Region	Activity	Partner	Stet	1990	1995	2000	2005	2007
Africa	Exports	World		106,000	112,000	147,800	297,700	424,100
Africa	Imports	World		99,600	126,700	129,400	249,300	358,900
Asia	Exports	World		792,400	1,446,800	1,836,200	3,050,900	4,131,000
Asia	Imports	World		761,500	1,403,300	1,677,100	2,871,000	3,804,300
Europe	Exports	World		1,684,940	2,335,635	2,633,930	4,371,915	5,722,205
Europe	Imports	World		1,750,925	2,334,760	2,774,755	4,542,675	6,060,845
Mid. East	Exports	World		138,400	151,000	268,000	538,000	759,900
Mid. East	Imports	World		101,300	132,500	167,400	322,100	479,300
N. America	Exports	World		562,035	856,550	1,224,975	1,477,530	1,853,500
N. America	Imports	World		684,460	1,015,760	1,687,580	2,284,735	2,707,460
S./C. America	Exports	World		106,000	148,900	195,800	354,900	499,200
S./C. America	Imports	World		85,900	176,900	206,300	297,600	456,000
World	Exports	World		3,449,000	5,164,000	6,452,000	10,431,000	13,950,000
World	Imports	World		3,550,000	5,284,000	6,724,000	10,783,000	14,244,000

Total Trade in Commercial Services — **Unit: U.S. dollar at current prices (millions)**

Region	Activity	Partner	1985	1990	1995	2000	2005	2007
Africa	Exports	World		18,600	25,700	31,300	56,900	78,400
Africa	Imports	World		26,500	34,400	37,400	69,300	102,100
Asia	Exports	World		131,500	257,800	309,500	525,300	739,600
Asia	Imports	World		178,800	328,100	367,900	573,500	760,000
Europe	Exports	World			597,100	721,900	1,244,800	1,703,200
Europe	Imports	World			560,200	674,100	1,120,100	1,461,300
Mid. East	Exports	World				33,100	54,900	76,900
Mid. East	Imports	World				48,800	85,400	132,900
N. America	Exports	World		135,500	171,200	268,200	366,300	535,600
N. America	Imports	World		135,500	171,200	268,200	366,300	440,100
S./C. America	Exports	World		22,400	34,600	47,100	68,200	92,200
S./C. America	Imports	World		24,900	45,300	54,600	70,500	98,600
World	Exports	World		780,500	1,185,100	1,491,000	2,414,300	3,291,500
World	Imports	World		820,500	1,200,700	1,474,600	2,347,400	3,085,900

Source: World Trade Organization, International Trade Statistics, 2008.

Japan's Cannon Inc. sells cameras and other professional and consumer imaging equipment in virtually every country of the world. An aggregation of such disclosures for all MNCs in all countries would confirm that trade today is neither bilateral nor regional, but truly global.

EXHIBIT 1-3 Selected 2008 Foreign Operations Data for AKZO Nobel (Euro millions)

	Net Sales By Destination	Capital Expenditures	Invested Capital	Number of Employees
The Netherlands	867	86	2,007	5,000
Germany	1,141	25	1,006	3,600
Sweden	478	50	557	3,800
U.K.	1,093	31	1,324	4,200
Other Europe	3,666	81	2,359	3,666
U.S./Canada	3,330	94	3,250	12,000
Latin America	1,306	49	776	4,800
China	1,054	67	861	6,300
Other Asia	1,866	43	1,030	7,800
Other regions	614	8	174	2,400

A major accounting issue associated with export and import activities relates to accounting for foreign currency transactions. Assume, for example, that Heineken exports a certain quantity of beer to a Brazilian importer and invoices the sale in Brazilian reals. Should the real devalue relative to the euro prior to collection, Heineken will experience a foreign exchange loss as reals will yield less euros upon conversion after the devaluation than before. The measurement of this transaction loss is not straightforward and is a subject that is dealt with in Chapter 6.

Today, international business transcends foreign trade and is increasingly associated with foreign direct investments, which involve operating production or distribution systems abroad by way of a wholly or majority-owned affiliate, a joint venture, or a strategic alliance.

While there is clearly a developed country bias of foreign direct investors, the boom of foreign direct investment flows to developing countries since the early 1990s indicates that MNCs are increasingly finding these host countries to be attractive investment locations.[3]

At the level of the firm, foreign direct investment activities are captured by a company's segmental disclosures and its roster of shareholdings in affiliated companies. Exhibit 1-3 also provides operating statistics by region for AKZO Nobel.

Exhibit 1-4 illustrates the extensive holdings in operating group companies of Nestle, one of the world's largest food and beverage companies headquartered in Vevy, Switzerland. While both AKZO and Nestle's foreign operations are extensive, the numbers relating to capital expenditures, invested capital, production sold locally, and number of foreign employees understate the extent of their foreign operations. They do not reflect the extent of either company's joint venture, strategic alliance, or other cooperative arrangements.

[3] World Bank Chief Economist, Francois Bourguignon, predicts that over the next 25 years, developing countries will move to the center stage in the global economy, "Global Economic Prospects 2007: Managing the Next Wave of Globalization," World Bank Panel Discussion sponsored by the Global Business Institute, NYU Stern School of Business, December 12, 2006.

EXHIBIT 1-4 Countries in Which Nestle Owns One or More Majority-Owned Companies

Europe		Egypt	2	Dom Rep.	1
Germany	14	Gabon	1	Trinidad	2
Austria	4	Ghana	1	Uruguay	1
Belgium	8	Guinea	1	Venezuela	3
Bulgaria	1	Kenya	1	**Asia**	
Crotia	1	Mauritius	2	Saudi Arabia	3
Denmark	3	Morocco	1	Bangladesh	1
Spain	10	Mozambique	1	Cambodia	1
Finland	3	Niger	1	UAE	1
France	18	Nigeria	1	India	2
Greece	2	Senegal	1	Indonesia	1
Hungary	5	Tunisia	1	Israel	1
Italy	8	Zimbabwe	1	Japan	9
Lithuania	1	**Americas**		Jordan	1
Malta	1	Argentina	3	Kuwait	1
Norway	3	Bolivia	1	Lebanon	3
The Netherlands	6	Brazil	5	Malaysia	7
Poland	5	Canada	2	Pakistan	1
Portugal	7	Chile	2	Philippines	4
Ireland	1	Colombia	5	S. Korea	4
Czech R.	3	Costa Rica	1	China	21
Romania	1	Cuba	2	Singapore	1
U.K.	9	Salvador	2	Sri Lanka	1
Russia	12	Ecuador	2	Syria	2
Serbia	1	U.S.	9	Thailand	9
Slovakia	1	Guatemala	1	Vietnam	2
Sweden	7	Honduras	1	**Oceana**	
Switzerland	8	Jamaica	1	Australia	3
Turkey	3	Mexico	8	Fiji	1
Ukraine	3	Nicaragua	2	N. Zealand	1
Africa		Panama	2	New Guinea	1
S. Africa	4	Paraguay	1	F. Polynesia	1
Cameroon	1	Peru	1	New Caledonia 1	1
Cote d'Ivoire	1	Puerto Rico	2		

Note: This list is conservative as it does not include affiliated companies for which proportionate consolidation is employed, associated companies for which the equity method is used, subholding financial and property companies, and technical assistance, research and development companies.

Operations conducted in foreign countries expose both financial managers and accountants alike to an additional set of problems that they do not encounter when solely engaged in international trade. As one example, how should an MNC like Nestle report the results of its operations, both domestic and international, to its South Korean investors? Each affiliate listed in Exhibit 1-4 must prepare its accounts according to the generally accepted accounting principles of the country in which it is domiciled for statutory and tax purposes. As Chapters 3 and 4 will attest, national financial reporting principles can vary significantly from country to country as they are shaped by different socio-economic environments. Environmental influences that impinge on accounting development are examined in Chapter 2. Nestle's domestic shareholders are used to seeing reports on the basis of Swiss reporting conventions. Examination of Nestle's accounting policies on consolidation suggests that the company first restates all of its foreign accounts to the reporting framework of the parent company prior to consolidation. The report of Nestle's auditors state that the consolidated financial statements comply with Swiss Law and are in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) and with the Interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC). But in restating from one set of principles to another, does something get lost in the translation? To illustrate, Mexican companies adjust their financial statements for changing prices (a subject that we cover in Chapter 7), owing to serious bouts of inflation in the past. Their adjustment for changing prices utilizes a methodology that incorporates changes in specific prices or replacement costs. Nestle, on the other hand, restates assets located in hyperinflationary countries for changes in the general purchasing power of the local currency prior to consolidation. Since general price changes seldom move in tandom with specific price changes, does Nestle's methodology reduce the information content of the Mexican subsidiary's inflation-adjusted accounts? Yamaha, producer of world-renowned musical instruments and other lifestyle products, expresses this concern in the first footnote to its consolidated financial accounts:

> Yamaha Corporation (the Company) and its domestic subsidiaries maintain their accounting records and prepare their financial statements in accordance with accounting principles and practices generally accepted in Japan, and its foreign subsidiaries maintain their books of account in conformity with those of their countries of domicile. The Company and all consolidated subsidiaries are referred to as the "Group." The accompanying consolidated financial statements have been prepared from the financial statements filed with the Ministry of Finance as required by the Securities and Exchange Law of Japan. Accordingly, the accompanying consolidated financial statements may differ in certain significant respects from accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

Then there is the choice of exchange rate to use in converting foreign accounts to a single reporting currency. As Chapter 6 explains, there are a variety of rates that an MNC can use. As foreign exchange rates are seldom constant, restating accounts using exchange rates that gyrate almost daily produces gains and losses that can have a significant effect on the reported profitability and perceived riskiness of multinational operations. As you might suspect, accounting treatments for these gains and losses are far from uniform internationally.

Domestic readers are not the only audience that reporting entities must address. What about statement readers that are domiciled abroad? Their information needs must be considered when a firm seeks access to foreign sources of capital and at reasonable costs. Market access and cost of capital considerations are, in turn, related to the nature and quality of a firm's external financial communications. Should a company send the same set of accounts that it prepares for its domestic readers to its foreign readers? Or, should the reporting entity restate its reports according to the language, currency and/or accounting principles of the reader's country? This is not a trivial consideration as foreign readers are generally unaccustomed to providing money capital on the basis of an unfamiliar currency, language, and measurement framework. Evidence suggests that some institutional investors tend to exhibit a home country bias in their portfolio choices and tend to invest in nondomestic firms whose accounting and reporting methods conform to the GAAP framework that they are accustomed to.[4] Would you be interested in investing in the shares of a Chinese company if the numbers in the annual report you received were expressed in Renmenbi, the text written in Mandarin, and the accounting measurements based on Chinese GAAP?

Both AKZO and Nestle, mentioned earlier, have chosen to accommodate their foreign readers by restating their financial statements to International Financial Reporting Standards (IFRS). AKZO's initiative is in compliance with a European Union (EU) directive that mandates all EU listed companies to follow IASB standards. Nestle's decision is voluntary as its decision to conform to IFRS predates the EU requirement. Issues associated with management's use of special disclosures for nondomestic financial statement readers are covered in Chapter 5.

In addition to external reporting, a firm's internal users of accounting information, that is, financial managers and accountants, must also understand the effects of environmental complexities of an MNE's accounting measurements. Discussion of these topics begins in Chapter 10. For example, understanding the effects of changes in foreign exchange and inflation rates is critical in areas such as the preparation of short- and long-term budgets for parent companies and their subsidiaries (or branches), measuring and evaluating the performance of local business units and managers, and making corporate-wide decisions on the allocation of investment capital and retained earnings, among others. To make matters more complex, foreign exchange and inflation rates do not work in tandem. The effect on accounting measurements of changes in foreign exchange rates and foreign inflation is so pervasive that domestic financial control systems cannot serve managers well in the absence of appropriate environmental adaptation. Then there are issues of management control. While companies often expand operations abroad to take advantage of low-cost labor or untapped markets, productivity and decision-making styles can be so different that company expectations are often met with disappointment. Imposing culturally inappropriate control systems on foreign managers only magnifies such disappointments.[5] Managerial accounting from an international perspective includes possibly the most complex and detailed material in this book.

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[4] See Mark T. Bradshaw, Brian J. Bushee, and Gregory S. Miller, "Accounting Choice, Home Bias and U.S. Investments in Non-U.S. Firms," *Journal of Accounting Research*, 42, No. 5 (December 2004): 795–841.

[5] Stephen B. Salter, Philip A. Lewis, and Luis Felipe Juarez Valdes, "Aqui No Se Habla Agencia. An Examination of the Impact of Adverse Selection and Framing in Decision-Making: a US/Mexico Comparison," *Journal of International Financial Management and Accounting*, 15, No. 2 (June 2004): 93–117.

Chapter 12 addresses the important issues of international taxation and transfer pricing. Businesses that operate in more than one country need to carefully examine and manage their tax exposure.[6] Knowledge of tax codes and currency values is only the beginning. It is very possible that steps taken by management to lower taxes in one place will raise taxes elsewhere, possibly by an amount greater than the original reduction. The effects of tax strategies on corporate budgeting and control procedures must be considered carefully. For example, a good strategy to reduce taxes might have unintended effects on the performance evaluation system. Transfer prices—the prices charged to business units for internal transactions that cross national borders—frequently are set with tax minimization in mind. The basic idea is to concentrate expenses (as far as possible) in high-tax countries and to concentrate revenues in low-tax countries, thus maximizing overall profit. Governments are well aware of this strategy and have adopted complex rules to prevent abusive use of this strategy. While the notion of the "arm's-length" price is widespread, its definition and the methods for calculating it have many variations. On top of all this, unexpected changes in exchange rates or inflation rates can wreak havoc on tax planning strategy. Managerial accountants must often devise complex computer models to calculate the overall expected impact of a company's tax strategy.

FINANCIAL INNOVATION

Risk management has become a hot buzzword in corporate and financial circles. The reason is not hard to find. With continued deregulation of financial markets and capital controls volatility in the price of commodities, foreign exchange, credit, and equities has become the order of the day. These price gyrations not only impact internal reporting processes but also expose the firm to the risk of economic losses. This has spurred a host of managerial activities aimed at identifying a firm's exposure to this volatility, deciding which risks to hedge against, and evaluating the results of a given risk management strategy. The rapid growth of risk management services suggests that management can enhance firm value by managing market risks. Investors and other corporate stakeholders expect financial managers to identify and actively manage such exposures. At the same time, advances in financial technology have made it possible to shift market risks to someone else's shoulders. However, the burden of assessing counterparty risk, that is, the risk that this someone else will not default on their obligation, cannot be transferred and is now placed on the shoulders of a larger pool of market participants, many of whom may be located thousands of miles apart. The dependence this creates on international reporting practices and the resulting confusion caused by diversity in accounting for financial risk products is onerous. Those with risk management skills are highly valued by the market. Hence we devote an entire chapter, Chapter 11, to the topic of financial risk management.

[6] A good example in this regard is the international tax effects surrounding the contemporary use of fair values. See Edward Abahoonie and Yosef Barbut, "Fair Value Accounting: Tax Considerations," *Financial Executive*, (March 2009): 49–51.

GLOBAL COMPETITION

Another factor contributing to the growing importance of international accounting is the phenomenon of global competition. Benchmarking, the act of comparing one's performance against an appropriate standard, is not new. What is new is that standards of comparison now transcend national boundaries. The relevant question today is not "How am I doing relative to my competitor who may be right across the street?", but "Am I adding more value to my customer base than my counterpart who may be located in another country?"

In benchmarking against international competitors, one must be careful to ensure that comparisons are indeed comparable. For example, one frequently used performance metric is return on equity (ROE). In comparing the ROE of an American telecom company with India's Infosys, are you really comparing apples to apples or are you comparing apples to oranges?

Exhibit 1-5 suggests that differences in accounting measurements between countries could complicate meaningful comparisons. Exhibit 1-5 begins with the net income of Infosys as reported in its recent consolidated financial statements. For the convenience of U.S. investors, Infosys has translated its financial statements from Indian GAAP to U.S. GAAP. Net income and shareholders' equity figures are first reported based on Indian GAAP. These metrics are then modified by a series of adjustments that restate them to a basis consistent with U.S. GAAP. A comparison of the unadjusted ROE with the adjusted ROE yields return statistics of 33.8% versus 29.5%. While adjustments from

EXHIBIT 1-5 **Adjusting Infosys' Consolidated Earnings and Equity from Indian to U.S. GAAP (Dollars in millions)**

	U.S. GAAP	Indian GAAP
Revenues (Fiscal 08)	$4,176	$4,176
Cost of revenues	2,453	2,452
Gross profit	1,723	1,724
Selling and marketing expenses	230	229
General and administrative expenses	334	333
Amortization of intangible assets	8	—
Total operating expenses	572	562
Operating income	1,151	1,162
Other income, net	175	175
Income before income taxes	1,326	1,337
Provision for income taxes	171	171
Net income	$1,155	$1,166
ASSETS		
Cash and cash equivalents	$2,058	$2,058
Investments in liquid mutual fund units	18	18
Trade accounts receivable, net	824	824
Unbilled revenue	120	120
Prepaid expenses	107	107
Property, plant and equipment, net	1,022	1,022

(continued)

EXHIBIT 1-5 Adjusting Infosys' Consolidated Earnings and Equity from Indian to U.S. GAAP (Dollars in millions) (Continued)

	U.S. GAAP	Indian GAAP
Goodwill	150	172
Intangible assets, net	25	—
Deferred tax assets	68	74
Advance income taxes	55	55
Other assets	45	45
Total assets	$4,492	$4,495
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable	$ 12	$ 12
Income taxes payable	101	101
Client deposits	1	1
Unearned revenue	71	71
Other current and noncurrent liabilities	397	862
Common stock	64	64
Additional paid in capital	718	652
Retained earnings	2,817	2,432
Accumulated other comprehensive income	311	300
Total stockholders' equity	3,910	3,448
Total liabilities and stockholders' equity	$4,492	$4,495

Indian GAAP to U.S. GAAP did not have a significant effect on earnings, it did have a 13.4% effect on equity. Statement readers who are not aware of national measurement differences and required accounting adjustment algorithms are obviously at a disadvantage. These and related statement analysis considerations are the subject of Chapter 9.

CROSS-BORDER MERGERS AND ACQUISITIONS

As the global trend toward industrial consolidation continues, news about international mergers and acquisitions is practically a daily occurrence. While mergers are normally rationalized in terms of operating synergies or economies of scale, accounting plays a crucial role in these mega-consolidations as accounting numbers are fundamental in corporate valuation. Differences in national measurement rules can complicate the corporate valuation process (see Chapter 9).

For example, corporate valuations are often based on price multiples, such as the price-to-earnings (P/E) ratio. The approach here is to derive an average P/E multiple for comparable firms in the industry and apply this multiple to the reported earnings of the firm being valued to arrive at a reasonable offering price. A major concern of the acquiring firm when bidding for a foreign acquisition target is to what extent the E in the P/E metric is a true reflection of the attribute being measured, as opposed to the result of an accounting measurement difference!

Differences in accounting measurement rules could also create an unlevel playing field in the market for corporate control. Thus, if Company A in Country A is allowed to take purchased goodwill directly to reserves, while Company B in Country B must amortize purchased goodwill to earnings, Company A may very well enjoy a bidding advantage over B when seeking to acquire a common target company. Company A could offer a higher purchase price knowing that its earnings will not be penalized by the hit to earnings of any excessive premiums paid.

INTERNATIONALIZATION OF CAPITAL MARKETS

The factor that has perhaps contributed most to the growing interest in international accounting among corporate executives, investors, market regulators, accounting standard setters, and business educators alike is the internationalization of the world's capital markets. Statistics indicate that the dollar volume of cross-border equity flows increased by more than twenty-fold since 1990 while the value of international securities offerings more than quadrupuled during the same time period exceeding $1.5 trillion today. International offerings in bonds, syndicated loans, and other debt instruments have also grown dramatically since the 1990s. Investment banks Russel, Greenwich Associates, Morgan Stanley, Merrill Lynch, and Grail Partners estimate that global retail hedge fund investments will grow to $2.5 trillion by 2010, representing a 14.3% compounded annual growth rate since 2005.

As financial markets are becoming more integrated, we are witnessing an increase in the number of companies listed on the world's stock exchanges. Exhibit 1-6 discloses the number of domestic and foreign companies listed on the world's major exchanges. Over the last ten years, global market capitalization more than doubled to well over $40 trillion. The World Federation of Exchanges reports that while the number of domestic companies with shares listed increased in some markets and decreased in others during the early part of this decade, the average sizes and and annual trading volumes of listed companies have grown substantially, in part due to mergers and acquisitions, which also result in delistings of some of the entities involved.

In recent years, world financial markets have experienced tumultuous declines owing to the recent credit crisis and its effects on economic performance. On a relative basis, however, some emerging markets have experienced lower relative declines. Exhibit 1-7 discloses the percentage change in stock market capitalization, not to be confused with market returns, for the year ended 2008 in both U.S. dollars and local currency by international time zones. The countries listed exhibited the smallest declines in market capitalization in U.S. dollars from the prior year. It is notable that most of the exchanges identified were located in emerging markets. It should also be evident that foreign exchange rate changes must be taken into account by nondomestice investors when gauging market performance. It is not surprising that the traditional preference of investing in one's back yard is beginning to give way to investors exploiting the most attractive investment opportunities whereever they may be located.

The three largest equity market regions are the Americas, Asia-Pacific, and Europe, including Africa and the Middle East.[7] Since the tragic events of 9/11, markets in all three regions have grown significantly.

[7] Each equity market region is comprised of equity markets in multiple countries, and some of these national equity markets are comprised of several stock exchanges (as well as off-exchange trading systems). (For example, four stock exchanges operate in Spain and eight stock exchanges operate in the United States.) A stock exchange is an entity that plays a central role in the regulation of trading markets and develops, operates, and manages those markets.

EXHIBIT 1-6 Number of Listed Companies (Equity)

	2008			2007		
Exchange	**Total**	**Domestic Companies**	**Foreign Companies**	**Total**	**Domestic Companies**	**Foreign Companies**
Americas						
American SE	**486**	391	95	**599**	495	104
Bermuda SE	**52**	16	36	**53**	16	37
BM&FBOVESPA	**392**	383	9	**404**	395	9
Buenos Aires SE	**112**	107	5	**111**	106	5
Colombia SE	**89**	89	0	**90**	90	0
Lima SE	**244**	201	43	**226**	188	38
Mexican Exchange	**373**	125	248	**367**	125	242
NASDAQ OMX	**2,952**	2,616	336	**3,069**	2,762	307
NYSE Euronext (U.S.)	**3,011**	2,596	415	**2,297**	1,876	421
Santiago SE	**238**	235	3	**241**	238	3
TSX Group	**3,841**	3,755	86	**3,951**	3,881	70
Total region	***11,790***			***11,408***		
Asia-Pacific						
Australian SE	**2,009**	1,924	85	**1,998**	1,913	85
Bombay SE	**4,921**	4,921	0	**4,887**	4,887	0
Bursa Malaysia	**976**	972	4	**986**	983	3
Colombo SE	**235**	235	0	**235**	235	0
Hong Kong Exchanges	**1,261**	1,251	10	**1,241**	1,232	9
Indonesia SE	**396**	396	0	**383**	383	0
Jasdaq	**926**	926	0	**979**	979	0
Korea Exchange	**1,793**	1,789	4	**1,757**	1,755	2
National Stock Exchange India	**1,406**	1,406	0	**1,330**	1,330	0
New Zealand Exchange	**172**	147	25	**178**	152	26
Osaka SE	**470**	469	1	**477**	476	1
Philippine SE	**246**	244	2	**244**	242	2
Shanghai SE	**864**	864	0	**860**	860	0
Shenzhen SE	**740**	740	0	**670**	670	0
Singapore Exchange	**767**	455	312	**762**	472	290
Taiwan SE Corp.	**722**	718	4	**703**	698	5
Thailand SE	**525**	525	0	**523**	523	0
Tokyo SE Group	**2,390**	2,374	16	**2,414**	2,389	25
Total region	***20,819***			***20,627***		
Europe-Africa-Middle East						
Amman SE	**262**	262	0	**245**	245	0
Athens Exchange	**285**	282	3	**283**	280	3

(continued)

EXHIBIT 1-6 Number of Listed Companies (Equity) (Continued)

	2008			2007		
Exchange	**Total**	**Domestic Companies**	**Foreign Companies**	**Total**	**Domestic Companies**	**Foreign Companies**
BME Spanish Exchanges	**3,576**	3536	40	**3,537**	3498	39
Borsa Italiana	**300**	294	6	**307**	301	6
Budapest SE	**43**	40	3	**41**	39	2
Cyprus SE	**119**	119	0	**124**	124	0
Deutsche Börse	**832**	742	90	**866**	761	105
Egyptian Exchange	**373**	372	1	**435**	435	0
Irish SE	**68**	58	10	**73**	60	13
Istanbul SE	**317**	317	0	**319**	319	0
Johannesburg SE	**411**	367	44	**411**	374	37
Ljubljana SE	**84**	84	0	**87**	87	0
London SE	**3,096**	2,415	681	**3,307**	2,588	719
Luxembourg SE	**262**	34	228	**261**	34	227
Malta SE	**19**	19	0	**16**	16	0
Mauritius SE	**68**	65	3	**70**	67	3
NASDAQ OMX Nordic Exchange	**824**	801	23	**851**	825	26
NYSE Euronext (Europe)	**1,002**	1,002	0	**1,155**	930	225
Oslo Børs	**259**	209	50	**248**	208	40
SIX Swiss Exchange	**323**	253	70	**341**	257	84
Tehran SE	**356**	356	0	**329**	329	0
Tel Aviv SE	**642**	630	12	**657**	643	14
Warsaw SE	**458**	432	26	**375**	352	23
Wiener Börse	**118**	101	17	**119**	102	17
Total region	***14,097***			***14,457***		
WFE Total	**46,706**			**46,492**		

Americas

The U.S. economy and its stock market had unprecedented growth during the 1990s through 2008. Today both the NYSE and NASDAQ dominate other stock exchanges worldwide in terms of market capitalization, value of trading in domestic shares, value of trading in foreign shares (except for the London Stock Exchange [LSE]), numbers of domestic listed companies, and numbers of foreign listed companies. The relative importance of the Americas in the global equity market has also increased. Market capitalization in the Americas as a percentage of the global total stood at 43% at the start of 2008. But even here, the forces of global competition are making themselves felt. The Committee on Capital Market Regulation, whose members are appointed by the SEC in consultation with the Federal Reserve Board of Govenors and the U.S. Treasury, has concluded that the United States could lose its dominance in the global capital markets

EXHIBIT 1-7 Ten Exchanges Exhibiting the Smallest Relative Declines in Market Capitalization in 2008

Americas	% Change 2008/2007 (in USD)	% Change 2008/2007 (in local currency)
1. Bermuda	−30.0%	−30.0%
2. Buenos Aires SE	−30.2%	−23.3%
3. Colombia SE	−14.0%	−4.8%
4. Santiago SE	−38.1%	−20.4%
Region Total	−42.9%	
Asia-Pacific		
Jasdaq	−22.8%	−37.1%
Osaka SE	−30.5%	−43.4%
Tokyo SE	−28.1%	−41.4%
Region Total	−48.6%	
Europe-Africa-Middle East		
Amman SE	−12.9%	−13.0%
Malta SE	−36.5%	−33.4%
Tehran SE	11.0%	17.6%
Region Total	−49.3%	

unless it streamlines its regulatory provisions, which the market feels is onerous. This issue is discussed further in Chapter 8 in conjunction with the topic of corporate governance and the U.S. Sarbanes-Oxley Act.

Western Europe

Europe is the second largest equity market region in the world in terms of market capitalization and trading volume. Economic expansion significantly contributed to the rapid growth in European equity markets. A related factor in Continental Europe has been a gradual shift to an equity orientation that long has characterized the London and North American equity markets.[8] Privatizations of large government entities have made European equity markets more prominent and have attracted noninstitutional investors, who until recently were not active in Continental Europe. Finally, confidence in European markets has grown with the success of the European Monetary Union (EMU).

[8] Developed countries around the world can be divided roughly into those having a common law (English) orientation and those having a code law (Continental Europe) orientation (see Chapter 2). Common law countries include the United Kingdom, Canada, the United States, and Australia. In these countries, equity investors are widely dispersed and are the most important suppliers of capital. As a result, capital markets in many common law countries have evolved credible and open disclosure and accounting systems, and relatively stringent market regulation. In code law countries such as France, Germany, and Japan, banks provide most of the financing, and ownership tends to be concentrated among small groups of insiders. Demand for detailed public disclosure is generally lower in these countries than in common law countries, but is increasing.

European equity markets will continue to grow. Pension reforms, for one, are creating new demand for investment opportunities.[9] Also, more and more foreign investors are entering European equity markets. Cross-border equity flows are increasing as a percentage of cross-border bond flows, in part because equity has proved to be a profitable investment. In addition, the advent of the euro has prompted a rush of cross-border mergers, which are expected to continue.

Intense rivalry among European stock exchanges has contributed to the development of an equity culture. Continental European markets have become more investor oriented to increase their credibility and attract new listings. External investors, in particular foreign investors and institutional investors, are demanding expanded disclosure and improved corporate governance. In addition, equity market development has become increasingly important to national governments and regulators, who also compete for recognition and prestige. Many European securities regulators and stock exchanges have implemented more stringent market rules and are strengthening their enforcement efforts.

Asia

Many experts are predicting that Asia will become the second most important equity market region. The People's Republic of China (China) has emerged as a major global economy, and the "Asian Tiger" nations continue to experience phenomenal growth and development.

Critics argue that Asian accounting measurement, disclosure, and auditing standards and the monitoring and enforcement of those standards are weak.[10] Some Asian governments periodically announce that they will intervene in equity markets to boost share prices, and market manipulation is not uncommon.[11]

However, the prospects for continued growth in Asian equity markets are strong. Market capitalization as a percentage of gross domestic product (GDP) in Asia is lower than that in the United States and several major European markets. This suggests, however, that equity markets can play a much larger role in many Asian economies. Also, Asian governments and stock exchanges appear eager to improve market quality and credibility to attract investors.[12] As mentioned earlier, Asian-Pacific markets (e.g., China, India, Korea, Taiwan, and Hong Kong) have grown rapidly, and are experiencing heavy trading volume relative to market capitalization.

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[9] With aging populations causing the numbers of pensioners to increase, a major initiative across much of Europe has been to move toward the private funding of pensions. The goal is to relieve the strain on "pay-as-you-go" state pension schemes. The growing numbers of private pension funds are allocating more of their assets to equities to increase returns. Also, some countries are liberalizing restrictions on pension fund investment.

[10] These attributes are neither good nor bad. Each market develops in response to economic conditions, the nature of its investors, sources of financing, and other factors. In Japan, for example, banks have long been the primary sources of finance. These banks have had full access to inside information about Japanese companies, and so there has been less demand in Japan for credible external financial reporting.

[11] For example, Taiwan announced in November 2000 that it would institute emergency action to support share prices after a recent, dramatic fall.

[12] The Singapore Exchange has moved aggressively to position itself as the premier financial exchange in Asia outside of Japan. The exchange recently implemented new listing rules and more stringent disclosure requirements to attract new domestic and foreign listings.

Cross-Border Equity Listing and Issuance

The current wave of interest in cross-border listings on major world exchanges is not a chance phenomenon. Evidence suggests that issuers seek cross-border listings to broaden their shareholder base, promote awareness of their products, and/or build public awareness of the company, particularly in countries where the company has significant operations and/or major customers.

National regulators and stock exchanges compete fiercely for foreign listings and trade volume, considered necessary for any stock exchange that seeks to become or remain a global leader. In response, organized exchanges and market regulators have worked to make access faster and less costly for foreign issuers and at the same time increase their markets' credibility. As capital markets become more specialized, each can offer unique benefits to foreign issuers.

Many companies have difficulty deciding where to raise capital or list their shares. Knowledge of many equity markets with different laws, regulations, and institutional features is now required. Also required is an understanding of how issuer and stock exchange characteristics interact. The issuer's home country, industry, and offering size are just some of the factors that need to be considered.[13] In addition, the costs and benefits of different market combinations need to be understood. One entrepreneur planning to raise capital said, "I spoke to three investment banks about it, and I had three different answers about which would be the right market for me." Exhibit 1-8 presents a detailed list of factors companies consider in choosing a foreign capital market.[14]

The pace of change in the world's capital markets show no signs of slowing. One example is the growing importance of stock exchange alliances and consolidation. In a strategic move, the New York Stock Exchange acquired Euronext, the pan-European stock exchange created by a merger of the Amsterdam, Brussels, Lisbon, and Paris exchanges. This business combination creates the world's first trans-Atlantic stock market. Some are even predicting that financial markets and trading will be dominated by two or three global exchange groups operating across continents within the not too distant future.[15] This will increase significantly the exposure of international investors to international companies. Similarly, the emergence of newer markets, such as London's Alternative Investment Market (AIM), France's Alternext and Germany's Entry Standard, expands the pool of companies that can now break the bonds of local debt financing. All of these developments present a highly complex setting for financial reporting regulation.

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[13] Home country is relevant because companies can raise capital more easily in foreign countries that have legal and regulatory environments similar to their own. For example, an Australian company can probably access the U.K. equity market more easily than the French equity market. Industry is important because, other things equal, issuers seek to raise capital in markets where other companies in the same industry are listed in order to improve the chances for adequate attention by financial analysts. For example, the SWX Swiss Exchange's New Market is attractive to biotechnology companies in part because Novartis and Roche (two of the world's largest pharmaceutical companies) are listed on the SWX Swiss Exchange and have attracted many pharmaceutical/biotech analysts to Zurich. Offering size is important because only relatively large offerings attract sufficient attention in the United States. Much smaller IPOs are common in Europe's new markets.

[14] Appendix 1-1 presents Web site addresses for stock exchanges in more than 50 countries. Many stock exchange Web sites include information on unique stock exchange features that may attract foreign companies considering listing or raising capital in those markets.

[15] Alistair McDonald, "Euronext Head Sees Markets Dominated by Global Exchanges," *WSJ Online*, Jannuary 22, 2007.

EXHIBIT 1-8 Factors Relevant in Choosing an Overseas Market

1. What is the extent of interest in a company shown by financial analysts and investors who normally participate in a market?
2. What is the level of trading activity on the exchange? Higher trading volume means more potential buyers of a company's securities.
3. How easy is it to raise capital? Some jurisdictions have complex listing or ongoing reporting requirements that may be difficult or impossible for a smaller company to meet.
4. What is the availability of capital in a market?
5. What is the reputation of the exchange? A growing international company may want the increased credibility and recognition that come with listing on a preeminent market such as the New York Stock Exchange.
6. To what extent does the company desire to raise its profile and establish its brand identity in a particular market? A stock exchange listing can benefit companies that operate or plan to operate in an overseas country.
7. To what extent are the market's regulatory environment and language similar to those in the company's home market? For example, a company from an English-speaking country with a common law (British-American) legal and regulatory system, such as Australia, might find it easier to list in the United Kingdom than in Continental Europe.
8. To what extent do institutional investors face statutory or self-imposed restrictions on the proportion of their investment portfolio that they can hold in securities of foreign companies? Sometimes these restrictions force a large international company to list on many stock exchanges to have access to sufficient institutional capital. These restrictions are difficult to overcome in some jurisdictions.
9. What are the nature and activities of investors in the market? For example, large pension funds in the Netherlands, Switzerland, and the United Kingdom invest heavily in equities of both domestic and foreign companies.
10. What is the likelihood that the company will be required to have locally listed shares to carry out a merger or acquisition in a particular country?
11. Will there be a need for locally listed shares to be used in employee stock option plans?

WHERE ARE WE?

The rapid growth in global capital markets and cross-border investment activity means that the international dimensions of accounting are more important than ever for professionals who have to deal in one way or another with these areas. Accounting plays a critical role in the efficient functioning of capital markets. Lenders, investors, financial analysts, regulators, and stock exchanges require information about the financial performance, position, and the future prospects of companies seeking financing. In turn, the needs of capital market participants have strongly shaped the development of accounting practice, as discussed in Chapter 2. Demands of market participants strongly influence companies' accounting and disclosure choices and national and international efforts to harmonize accounting measurement, disclosure, and auditing practices around the world.

How does, for example, a British or American investor make sense of Japanese accounts or Brazilian accounts where measurement and transparency rules are very different from what they are typically accustomed to? Until Japan and Brazil formally implement international financial reporting standards, should investors attempt to restate Japanese or Brazilian accounts to a more familiar set of reporting norms such as U.S. or IASB measurement rules prior to analysis? Or should they put themselves in the shoes of a Japanese or Brazilian shareholder and conduct their analysis from a local perspective? These and other related issues are covered in Chapter 9.

On the other side of the coin, a major factor motivating many corporations to raise monies abroad is to increase their access to funds and lower their capital costs. The challenge here is trying to ensure that the foreign reader receives the same intended message as the domestic reader. This challenge is significant in a world where firms compete for funds, an issue explored in Chapter 5.

LEARNING OBJECTIVES

Having set the stage for your study of international accounting, we identify below the essential ideas that you should get out of each chapter. We invite you to revisit this section before you begin reading each chapter and upon completion of each chapter to be sure that you understand the essential ideas that are being conveyed. This text is intended to sensitize you to the important concepts and issues in the field of international accounting and reporting, and in so doing, enable you to ask the "right questions" as a reader of international financial statements, whether you opt for a career in the corporate, legal, financial services, or not-for-profit world.

After studying Chapter 1, you should be able to:

1. Explain how international accounting is distinct from domestic accounting.
2. Describe what the term *accounting diversity* entails.
3. Identify the factors that are contributing to the internationalization of the subject of accounting.
4. Understand how foreign direct investment activities differ from international trade and the implications of this difference for accounting.
5. Appreciate, in general terms, the historic development of international accounting.
6. Comprehend the reasons why the study of international accounting is so important.
7. Identify several internal and external reporting issues that arise when business and investments transcend national borders.
8. Explain what is meant by *global capital markets* and what this development means for capital market participants.

After studying Chapter 2, you should be able to:

1. Identify and understand the importance of the eight factors that have a significant influence on accounting development.
2. Understand the four approaches to accounting development found in market-oriented Western economies and identify countries in which each one in prevalent.
3. Have a basic working knowledge of accounting classifications and how they compare with one another.
4. Explain the difference between the "fair presentation" and "legal compliance" orientations of accounting and identify nations in which each is prevalent.
5. Explain why distinctions of accounting at the national level are becoming blurred.

After studying Chapter 3, you should be able to:

1. Understand how financial reporting is regulated and enforced in five European countries: France, Germany, the Czech Republic, the Netherlands, and the United Kingdom.
2. Describe the key similarities and differences among the accounting systems of these five countries.
3. Identify the use of International Financial Reporting Standards at the individual company and consolidated financial statement levels in these five countries.
4. Describe the audit oversight mechanisms in these five countries.

After studying Chapter 4, you should be able to:

1. Understand how financial reporting is regulated and enforced in five countries of the Americas and Asia: the United States, Mexico, Japan, China, and India.
2. Describe the key similarities and differences among the accounting systems of these five countries.
3. Describe the auditor oversight mechanisms in these five countries.
4. Explain the difference between principle-based and rules-based accounting standards.

After studying Chapter 5, you should be able to:

1. Distinguish voluntary and mandatory disclosure and its regulation.
2. Identify the broad objectives for accounting disclosure systems in investor-oriented equity markets.
3. Discuss "triple bottom line" reporting and why it is a growing tendency among large multinational corporations.
4. Gain a basic understanding of the following selected corporate financial disclosure practices: (a) disclosures of forward-looking information, (b) segment disclosures, (c) social responsibility reporting, (d) special disclosures for nondomestic financial statement users, and (e) corporate governance disclosures.

After studying Chapter 6, you should be able to:

1. Describe the nature of foreign currency transactions done in the spot, forward, and swap markets.
2. Understand the foreign currency translation terms set forth in Exhibit 6-1.
3. Explain the difference between a translation gain or loss and a transaction gain or loss.
4. Comprehend alternative foreign currency translation methods that exist and their rationale.
5. Evaluate which of the available foreign currency translation methods are best under which specific business and currency market conditions.
6. Compare and contrast the financial statement effects of the temporal versus the current rate method of foreign currency translation.
7. Understand the relationship between foreign currency translation and inflation.
8. Appreciate how foreign currency translation is handled outside the United States.

After studying Chapter 7, you should be able to:

1. Understand why financial statements potentially are misleading during periods of changing prices.
2. Define the inflation accounting terms listed in Exhibit 7-1.
3. Comprehend the effect of general price-level adjustments on financial statement amounts.
4. Describe in what ways the current cost accounting framework differs from conventional accounting.
5. Appreciate how and why adjustments for changing prices may vary from country to country.
6. Have a basic understanding of the IASB's pronouncement on changing prices in "hyperinflationary economies."
7. Discuss whether constant dollars or current costs better measure the effects of changing prices.
8. Understand how changing prices and foreign exchange rates are related and their financial statement effects.

After studying Chapter 8, you should be able to:

1. Define and understand the distinction between "harmonization" and "convergence" as they apply to accounting standards.
2. State the pros and cons of adopting international accounting standards.
3. Understand what is meant by "reconciliation" and "mutual recognition" of different sets of accounting standards.
4. Identify the six organizations that have leading roles in setting international accounting standards and in promoting international accounting convergence.
5. Describe the structure of the International Accounting Standards Board and how it sets International Financial Reporting Standards.
6. Understand what the major provisions of the U.S. Sarbanes-Oxley Act are and why similar legislation is being enacted in other countries.

After studying Chapter 9, you should be able to:

1. Understand the special difficulties involved in undertaking international business strategy analysis.
2. Identify basic approaches to information gathering.
3. Describe the steps involved in conducting an accounting analysis.
4. Appreciate the impact on accounting analysis of (a) cross-country variation in accounting measurement, disclosure, and auditing quality and (b) the difficulty in obtaining necessary information.
5. Comprehend several coping mechanisms available to deal with cross-country accounting measurement differences.
6. Expose the particular difficulties and pitfalls involved in doing an international prospective analysis.
7. Undertake a more intelligent approach to international financial ratio analysis.
8. Appreciate national variations associated with the audit or attest function.

After studying Chapter 10, you should be able to:

1. Identify four critical dimensions of business modeling.
2. Understand the distinction between standard and Kaizen costing concepts.
3. Measure expected returns of a foreign investment.
4. Calculate (in general fashion) a firm's cost of capital in a multinational framework.
5. Comprehend the basic issues and complexities involved in designing multinational information and financial control systems.
6. Perform an exchange rate variance analysis.
7. State the unique difficulties involved in designing and implementing performance evaluation systems in multinational companies.
8. Deal with the effects of inflation and exchange rate fluctuation on performance measurement of multinational companies.

After studying Chapter 11, you should be able to:

1. Describe what Enterprise Risk Management (ERM) entails.
2. Define market risk and provide an example of this risk with a foreign exchange example.
3. State four tasks involved in managing foreign exchange risk.
4. Define and calculate translation exposure.
5. Define and calculate transaction exposure.
6. Understand the distinction between accounting exposure and economic exposure.
7. Explain what a financial derivative is and the accounting issues associated with it.
8. Comprehend the types of foreign currency hedges recognized by IAS 39 and FAS 133 and their accounting treatments.

After studying Chapter 12, you should be able to:

1. Identify the major types of tax systems that exist around the world.
2. Understand what determines a multinational entity's effective tax burden.
3. Understand concepts relating to the taxation of foreign source income and the rationale behind the foreign tax credit.
4. Identify the major variables that complicate international transfer pricing.
5. Explain the meaning of *arm's-length price* and the transfer pricing methods designed to achieve it.
6. Explain what an advance pricing arrangement is.

Appendix 1-1

Stock Exchange Web Sites

Country	Stock Exchange	Web Site
Argentina	Buenos Aires	www.bcba.sba.com.ar
Australia	Australia	www.asx.com.au
Austria	Vienna	www.wbag.at
Azerbaijan	Baku	www.az/bicex
Belgium	Euronext—Belgium	www.euronext.com www.stockexchange.be/enindex.htm
Bermuda	Bermuda	www.bsx.com
Brazil	Rio de Janeiro	www.bvrj.com.br (Portuguese only)
Brazil	Sao Paulo	www.bovespa.com.br (Portuguese only)
Canada	Montréal	www.me.org
Canada	Toronto	www.tse.com
Canada	Canadian Venture	www.cdnx.ca
Chile	Santiago	www.bolsadesantiago.com
China	Schenzhen	222.sse.org.cn
Colombia	Bogotá	www.bolsabogata.com.co/ (Spanish only)
Colombia	Medellín	www.bolsamed.com.co (Spanish only)
Croatia	Zagreb	www.zse.hr
Czech Republic	Prague	www.pse.cz
Denmark	Copenhagen	www.xcse.dk
Finland	Helsinki	www.hex.fi
France	Paris	www.euronext.com www.bourse-de-paris.fr/defaultgb.htm
Germany	Deutsche Börse	deutsche-boerse.com/
Greece	Athens	www.ase.gr
Hong Kong	Hong Kong	www.hkex.com.hk
India	National Stock Exchange	www.nseindia.com
India	Surabaya	www.bes.co.id
Indonesia	Jakarta	www.jsx.co.id
Iran	Tehran	www.tse.or.ir
Israel	Tel-Aviv	hebrew.tase.co.il/www/intro.asp
Italy	Italy	www.borsaitalia.it
Japan	Osaka	www.ose.or.jp
Japan	Tokyo	www.tse.or.jp
Jordan	Amman	www.access2arabia.com/AFM/
Luxembourg	Luxembourg	www.bourse.lu
Macedonia	Macedonian	www.mse.org.mk

(continued)

Country	Stock Exchange	Web Site
Malaysia	Kuala Lumpur	www.klse.com.my
Mexico	Mexico	www.bmv.com.mx
Netherlands	Euronext—Netherlands	www.euronext.com
		www.aex.nl/aex.asp?taal=en
New Zealand	New Zealand	www.nzse.co.nz
Norway	Oslo	www.ose.no
Pakistan	Lahore	www.lse.brain.net.pk
Peru	Lima	www.bvl.com.pe
Philippines	Philippines	www.pse.org.ph
Poland	Warsaw	www.gpw.com.pl
Portugal	Lisbon	www.bvl.pt
Russia	Siberian	www.sse.nsk.su (Russian only)
Singapore	Singapore	www.ses.com.sg
Slovakia	Bratislava	www.bsse.sk
Slovenia	Ljubljana	www.ljse.si
South Africa	Johannesburg	www.jse.co.za
South Korea	Korea	www.kse.or.kr
Spain	Barcelona	www.borsabcn.es
Spain	Bilbao	www.bolsabilbao.es
Spain	Madrid	www.bolsamadrid.es
Sweden	Stockholm	www.xsse.se
Switzerland	Swiss	www.swx.ch
Taiwan	Taiwan	www.tse.com.tw
Thailand	Thailand	www.set.or.th
Turkey	Istanbul	www.ise.org
United Kingdom	London	www.londonstockexchange.com
United States	American (Amex)	www.amex.com
United States	Chicago	www.chicagostockex.com
United States	Nasdaq	www.nasdaq.com
		www.nasdaqnews.com
		www.nasdr.com
		www.nasdaqtrader.com
United States	New York	www.nyse.com

Note: All Web site addresses here begin with the prefix http://

Appendix 1-2

Financial Statements and Selected Notes from the Annual Report of INFOSYS.

Please refer to pages 85-148 of the 2009 annual report of Infosys. Its web address is www.infosys.com.

Discussion Questions

1. Explain how international accounting differs from purely domestic accounting.
2. Accounting may be viewed as having three components: measurement, disclosure, and auditing. What are the advantages and disadvantages of this classification? Can you suggest alternative classifications that might be useful?
3. What contemporary factors are contributing to the internationalization of the subject of accounting?
4. Describe in two short paragraphs how foreign direct investment activities differ from international trade and the implications of this difference for accounting.
5. Given the international heritage of accounting, do you feel that efforts to harmonize global accounting standards are a good thing? Why or why not?
6. Why have international accounting issues grown in importance and complexity in recent years?
7. Identify several internal and external reporting issues that arise when business and investments transcend national borders.
8. Explain the term global capital markets. This chapter primarily discusses global equity markets. What other types of financial instruments are traded in these markets? How important are global capital markets in the world economy?
9. Over time, national governments in many countries have sold shares in state-owned financial institutions to nongovernmental entities. Discuss how these privatizations might affect the capital markets as well as the accounting systems of these companies.
10. Outsourcing, especially from vendors located abroad, has become a politically sensitive issue, especially in the United States. Do you think this argument has merit? What are the consequences of this debate for international accounting?

Exercises

1. Re-examine Exhibit 1-1 which describes the outsourcing process for HP's production of the Proliant ML150. For each leg of the production chain, identify the various accounting and related issues that might arise.
2. Examine Exhibit 1-2 and compute the compounded annual growth rate of merchandise trade versus the global trade in services for the 20 year period beginning 1985 and ending 2005. What implication does your finding have for accounting as a service activity?
3. Examine the Web sites of five exchanges listed in Appendix 1-1 that you feel would be most attractive to foreign listers. Which exchange in your chosen set proved most popular during the last two years? Provide possible explanations for your observation.
4. Does the geographic pattern of merchandise exports contained in Exhibit 1-2 correlate well with the pattern of AKZO Nobel's geographic distribution of sales shown in Exhibit 1-3? What might explain any differences you observe?
5. What international reporting issues are triggered by AKZO NOBEL's foreign operations disclosures appearing in Exhibit 1-3 for investors? For managerial accountants?
6. Exhibit 1-4 lists the number of majority-owned foreign affiliates in each country that Nestle includes in its consolidated results. What international accounting issues are triggered by this Exhibit?
7. Revisit Exhibit 1-5 and show how the ROE statistics of 33.8 percent and 29.5 percent were derived. Which of the two ROE statistics is the better performance measure to use when comparing the financial performance of Infosys with that of Verizon, a leading U.S. telecom company?
8. Stock exchange Web sites vary considerably in the information they provide and their ease of use.

   Required: Select any two of the stock exchanges presented in Appendix 1-1. Explore the Web sites of each of these stock exchanges. Prepare a table that compares and contrasts the sites for types and quality of information presented and the ease of using the Web site. Are English-language press releases of listed companies available? Links to listed companies' Web sites? Listing requirements? Price and volume data for listed securities? Helpful information for investors?

9. Referring to Exhibit 1-6, which geographic region of the world, the Americas, Asia-Pacific, or Europe-Africa-Middle East is experiencing the most activity in foreign listings? Do you expect this pattern to persist in the future? Please explain.

10. If you had a nontrivial sum of money to invest and decided to invest it in a country index fund, in which country or countries identified in Exhibit 1-7 would you invest your money? What accounting issues would play a role in your decision?

CASES

Case 1-1

E-centives, Inc.—Raising Capital in Switzerland

On October 3, 2000, E-centives, incorporated in the United States, made an initial public offering on the Swiss Stock Exchange's New Market. The company raised approximately US$40 million. E-centive's offering circular stated that no offers or sales of the company's common stock would be made in the United States, and that there would be no public market for the common stock in the United States after the offering.

The Swiss Exchange's

New Market

The Swiss Exchange launched the New Market in 1999. The New Market is designed to meet the financing needs of rapidly growing companies from Switzerland and abroad. It provides firms with a simplified means of entry to the Swiss capital markets. Listing requirements for the New Market are simple. For example, companies must have an operating track record of 12 months, the initial public listing must involve a capital increase, and to ensure market liquidity, a bank must agree to make a market in the securities.

E-centives

E-centives, Inc. is a leading online direct marketing infrastructure company. The company offers systems and technologies that enable businesses to build large, rich databases of consumer profiles and interests. In return, consumers receive a free personalized service that provides them with promotional offers based on their interests. At the time of the public offering, E-centives maintained over 4.4 million e-centives online accounts for members. The company does not charge members a fee for its service. Instead, the company generates revenue primarily from marketers whose marketing matter is delivered to targeted groups of E-centives members. E-centives currently employs more than 100 people in its Bethesda, Maryland headquarters, and its offices in Redwood City, New York, and Los Angeles.

As of the offering date, the company had little revenue and had not been profitable. Revenue for the year-ended December 31, 1999, was US$740,000, with a net loss of about US$16 million. As of June 30, 2000, the company had an accumulated deficit of about US$39 million. E-centives' growth strategy is to expand internationally. To date, the company has focused on pursuing opportunities in the United States. E-centives intends to expand into Europe and other countries. The company is currently considering expanding into Switzerland, the United Kingdom, and Germany.[19]

Required

1. Refer to Exhibit 1-8, which lists factors relevant for choosing an overseas market for listing or raising capital. Which factors might have been relevant in E-centives' decision to raise capital and list on the Swiss Exchange's New Market?

[19] From E-centives' offering circular dated October 2, 2000.

2. Why do you believe E-centives chose not to raise public equity in the United States? What are the potential drawbacks related to E-centives' decision not to raise capital in the U.S. public markets?
3. What are the advantages and disadvantages to E-centives of using U.S. GAAP?
4. Should the SWX Swiss Exchange require E-centives to prepare its financial statements using Swiss accounting standards?
5. Learn more about the New Market at the SWX Swiss Exchange's Web site (http://www.swx.com). What are the listing requirements for the New Market? What are the financial reporting requirements? Does E-centives appear to fit the profile of the typical New Market company?

Case 1-2

Global Benchmarks: Infosys Technologies Limited

Investors, individual, corporate and institutional, are increasingly investing beyond national borders. The reason is not hard to find. Returns abroad, even after allowing for foreign currency exchange risk, have often exceeded those offered by domestic investments. Information provided in a firm's annual report is often the major source of information available to those seeking to sample foreign equities. In attempting to assess the risk and return attributes of a given company, readers must answer questions such as the following: What accounting principles were employed? Should the financial statements be restated according to a different set of accounting principles to be more useful? What types of information are not provided that one would expect to find in financial statements of companies from the investor's home country? How would one compensate for limited disclosure? What does the audit report reveal about the level of audit quality? What auditing standards were used? Are they acceptable? Does the audit report mean the same thing as it does in the reader's home country?

Appendix 1-2 (refers you to) the financial statements (including selected notes) and auditor's report for Infosys Technologies Limited. Infosys was incorporated in 1981 as Infosys Consultants Private Limited, as a private company under the Indian Companies Act. Its name eventually evolved into Infosys Technologies Limited in 1992, when the company went public. Its mission is to provide high quality and cost competitive technology solutions for companies around the world. It has grown into a $5 billion company with a market capitalization in excess of $15 billion.

In examining the information (referred to) in Appendix 1-2, comment on how the statements of Infosys stack up to other companies in the industry in meeting the information needs of a nondomestic investor such as yourself. Specifically, what reporting practices raise issues for you? What reporting practices do you find particularly helpful? In preparing your critique, compare the reporting practices of Infosys to a service provider in your country, most of whom maintain corporate Web sites on the Internet.