CONTENTS

Pre	face	χV

Chapter 1 INTRODUCTION 1

Historical Perspective 2

Contemporary Perspective 3

Growth and Spread of Multinational Operations 4

Financial Innovation 10

Global Competition 11

Cross-Border Mergers and Acquisitions 12

Internationalization of Capital Markets 13

Americas 15

Western Europe 16

Asia 17

Cross-Border Equity Listing and Issuance 18

Where Are We? 19

Learning Objectives 20

Appendix 1-1: Stock Exchange Web Sites 24

Appendix 1-2: Financial Statements and Selected Notes from the Annual Report of INFOSYS 25

Discussion Questions 26 • Exercises 26

- ► CASE 1-1: E-centives, Inc.—Raising Capital in Switzerland 28
- ► CASE 1-2: Global Benchmarks: Infosys Technologies Limited 29

Chapter 2 DEVELOPMENT AND CLASSIFICATION 30

Development 31

Classification 37

Four Approaches to Accounting Development 37

Legal Systems: Common Law vs. Code Law Accounting 38

Practice Systems: Fair Presentation vs. Legal Compliance Accounting 39

Discussion Questions 41 • Exercises 42

- ► CASE 2-1: Are Classifications of Accounting Outmoded? 44
- ► CASE 2-2: Volkswagen Group 45

Chapter 3 COMPARATIVE ACCOUNTING: EUROPE 49

Some Observations about Accounting Standards and Practice 51 IFRS in the European Union 52

vi Contents

Five National Financial Accounting Systems 54

France 54

Germany 60

Czech Republic 65

The Netherlands 68

United Kingdom 73

Discussion Questions 79 • Exercises 79

- ► CASE 3-1: Old Habits Die Hard 81
- ► CASE 3-2a: What Difference Does It Really Make? 82
- ► CASE 3-2b: Do the Differences Really Matter? 83

Chapter 4 COMPARATIVE ACCOUNTING: THE AMERICAS AND ASIA 84

Five National Financial Accounting Systems 86

United States 86

Mexico 91

Japan 96

China 101

India 106

Discussion Questions 112 • Exercises 112

► CASE 4-1: Standing on Principles 115

► CASE 4-2: Casino Capital 116

Chapter 5 REPORTING AND DISCLOSURE 119

Development of Disclosure 119

Voluntary Disclosure 120

Regulatory Disclosure Requirements 121

The U.S. SEC Financial Reporting Debate 122

Reporting and Disclosure Practices 124

Disclosures of Forward-Looking Information 124

Segment Disclosures 125

Social Responsibility Reporting 130

Corporate Governance Disclosures 132

Internet Business Reporting and XBRL 157

Annual Report Disclosures in Emerging-Market Countries 158

Implications for Financial Statement Users

and Managers 159

Discussion Ouestions 160 • Exercises 160

► CASE 5-1: In the Green 162

► CASE 5-2: Seeing Is Believing 162

Contents vii

Chapter 6 FOREIGN CURRENCY TRANSLATION 164

Reasons for Translation 168

Background and Terminology 169

The Problem 172

Financial Statement Effects of Alternative Translation Rates 172

Foreign Currency Transactions 174

Single-Transaction Perspective 176

Two-Transaction Perspective 177

Foreign Currency Translation 178

Single Rate Method 178

Multiple Rate Methods 179

Financial Statement Effects 181

Which Is Best? 183

Appropriate Current Rate 185

Translation Gains and Losses 185

Deferral 186

Deferral and Amortization 186

Partial Deferral 187

No Deferral 187

Where Are We? 187

Translation Accounting Development 188

Pre-1965 188

1965-1975 188

1975-1981 188

1981-Present 189

Features of Standard No. 52/International Accounting Standard 21 189

Translation When *Local* Currency Is the Functional Currency 190

Translation When the *Parent* Currency Is the Functional Currency 190

Translation When *Foreign* Currency Is the Functional Currency 190

Measurement Issues 192

Reporting Perspective 192

What Happened to Historical Cost? 193

Concept of Income 193

Managed Earnings 193

viii Contents

Foreign Currency Translation and Inflation 194

Foreign Currency Translation Elsewhere 195

Appendix 6-1: Translation and Remeasurement Under FAS No. 52 196

Discussion Questions 200 • Exercises 201

► CASE 6-1: Regents Corporation 204

► CASE 6-2: Managing Offshore Investments: Whose Currency? 206

Chapter 7 FINANCIAL REPORTING AND CHANGING PRICES 210

Changing Prices Defined 214

Why are Financial Statements Potentially Misleading During Periods of Changing Prices? 216

Types of Inflation Adjustments 217

General Price-Level Adjustments 218

Price Indexes 218

Use of Price Indexes 218

Object of General Price-Level Adjustments 219

Current-Cost Adjustments 222

General Price-Level Adjusted Current Costs 225

National Perspectives on Inflation Accounting 227

United States 227

United Kingdom 229

Brazil 230

International Accounting Standards Board 233

Inflation Issues 234

Inflation Gains and Losses 234

Holding Gains and Losses 235

Foreign Inflation 235

Avoiding the Double-Dip 236

Appendix 7-1: Accounting for Foreign Inflation: A Case Analysis 238

Discussion Ouestions 241 • Exercises 242

► CASE 7-1: Kashmir Enterprises 245

► CASE 7-2: Icelandic Enterprises, Inc. 246

Chapter 8 GLOBAL ACCOUNTING AND AUDITING STANDARDS 249

A Survey of International Convergence 250

Advantages of International Convergence 250

Criticisms of International Standards 252

Reconciliation and Mutual Recognition 252

Evaluation 253

Contents

ix

Some Significant Events in the History of International Accounting Standard Setting 253

Overview of Major International Organizations Promoting Accounting Convergence 255

International Accounting Standards Board 256

IASC's Core Standards and the IOSCO Agreement 261

The IASB Structure 262

Recognition and Support for the IASB 264

U.S. Securities and Exchange Commission Response to IFRS 264

European Union (EU) 265

Fourth, Seventh, and Eighth Directives 266

Transparency Directive 266

Have EU Harmonization Efforts Been Successful? 267

The EU's New Approach and the Integration of European Financial Markets 268

International Organization of Securities Commissions (IOSCO) 269

International Federation of Accountants (IFAC) 272

United Nations Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) 275

Organization for Economic Cooperation and Development (OECD) 275

Conclusion 275

Discussion Questions 276 • Exercises 276

► CASE 8-1: PetroChina Company Limited 279

► CASE 8-2: Whither The Withering Standard Setters? 280

Chapter 9 INTERNATIONAL FINANCIAL STATEMENT ANALYSIS 281

Introduction 281

Challenges and Opportunities in Cross-Border Analysis 281

Business Analysis Framework 283

International Business Strategy Analysis 283

Information Availability 284

Recommendations for Analysis 285

Accounting Analysis 285

Suggestions for the Analyst 287

x Contents

International Financial Analysis 288

Ratio Analysis 288

Cash Flow Analysis 291

Coping Mechanisms 291

International Prospective Analysis 292

Further Issues 295

Information Access 295

Foreign Currency Considerations 298

Differences in Statement Format 302

Language and Terminology Barriers 303

Financial Statement Analysis and Auditing 303

The Attest Function 304

The Audit Report 304

Auditing and Credibility 307

Coping Mechanisms 309

Internal Auditing 310

Professional Organization 312

Evolving Role of Internal Auditing 315

Appendix 9-1: Illustration of Restatement of Japanese GAAP Financial Statements to a U.S.

GAAP Basis 316

Appendix 9-2: International Ratio Analysis 320
Discussion Questions 322 • Exercises 322

► CASE 9-1: Sandvik 325

► CASE 9-2: Continental A.G. 331

Chapter 10 MANAGERIAL PLANNING AND CONTROL 340

Business Modeling 341

Planning Tools 341

Capital Budgeting 343

Financial Return Perspectives 344

Measuring Expected Returns 345

Multinational Cost of Capital 348

Management Information Systems 350

Systems Issues 350

Information Issues 352

Management Information and Hyperinflation 353

Sales Revenue 354

Issues in Financial Control 357

Domestic Versus Multinational Control System 358

Operational Budgeting 360

Analysis of Exchange Rate Changes 364

Strategic Costing 367

Performance Evaluation of Foreign Operations 369

Consistency 369

Unit Versus Managerial Performance 370

Performance Criteria 372

Measurement Issues and Changing Prices in Evaluation 374

Performance Evaluation Practices: ICI 374

Foreign Currency Effects 376

Performance Standards 377

Value Reporting 379

Discussion Questions 380 • Exercises 380

- ► CASE 10-1: Foreign Investment Analysis: A Tangled Affair 384
- ► CASE 10-2: Assessing Foreign Subsidiary Performance in a World of Floating Exchange Rates 386

Chapter 11 FINANCIAL RISK MANAGEMENT 388

Essentials 391

Why Manange Financial Risks? 391

Role of Accounting 392

Identifying Market Risks 392

Quantify Trade-offs 394

Risk Management in a World of Floating Exchange Rates 394

Forecasting Exchange Rate Changes 394

Translation Exposure 396

Transaction Exposure 400

Accounting Versus Economic Exposure 401

Accounting for Hedge Products 407

Practice Issues 413

Hedge of a Recognized Asset, Liability, or an Unrecognized Firm Commitment 414

Hedge of a Net Investment in a Foreign Operation 416

Speculating in Foreign Currency 417

Disclosure 418

Financial Control 422

xii Contents

Appropriate Benchmarks 422

Discussion Questions 423 • Exercises 424

► CASE 11-1: Exposure Identification 426

► CASE 11-2: Value at Risk: What Are Our Options? 426

Chapter 12 INTERNATIONAL TAXATION AND TRANSFER PRICING 431

Initial Concepts 432

Diversity of National Tax Systems 432

Types of Taxes 432

Tax Burdens 435

Tax Administration Systems 436

Foreign Tax Incentives 437

Tax Havens and Harmful Tax Competition 438

International Harmonization 438

Taxation of Foreign-Source Income and Double Taxation 439

Foreign Tax Credit 439

Limits to Tax Credits 441

Tax Treaties 442

Foreign Exchange Considerations 443

Tax-Planning Dimensions 443

Organizational Considerations 444

Controlled Foreign Corporations and Subpart F Income 444

Offshore Holding Companies 445

Financing Decisions 445

Pooling of Tax Credits 446

Cost Accounting Allocations 446

Location and Transfer Pricing 447

Integrating International Tax Planning 447

International Transfer Pricing: Complicating Variables 448

Tax Considerations 448

Tariff Considerations 450

Competitive Factors 450

Environmental Risks 451

Performance Evaluation Considerations 452

Resolving Trade-offs 452

Transfer Pricing Methodology 453

Market vs. Cost vs. . . . ? 453

Arm's-Length Principle 453

Contents xiii

Comparable Uncontrolled Price Method 454
Comparable Uncontrolled Transaction Method 454
Resale Price Method 454
Cost-Plus Pricing Method 455
Comparable Profits Method 457
Profit-Split Methods 457
Other Pricing Methods 458
Advance Pricing Agreements 459

Transfer Pricing Practices 460

The Future 460

Discussion Ouestions 462 • Exercises 462

► CASE 12-1: The Shirts Off Their Backs 465

► CASE 12-2: Muscle Max: Your Very Own Personal Trainer 467

Index 469