7. Global Accounting Issues

Understand that international trade no longer simply means importing and exporting. The notion of domestic and foreign operations is replaced by an understanding that trade and ownership has become global in nature. Companies have added subsidiaries in many countries, formed cooperative alliances, listed shares on multiple stock exchanges around the globe, engaged in global cross-border debt financing, and set up service centers that utilize technology to provide seamless customer support around the world. This is indeed a “megatrend” and a foray into uncharted terrain. Each of us, no matter where we live on this planet, is being touched by the phenomena. Indeed, persons from around the world are reading these same words at the same time as you. Likewise, financial data is being shared globally!

What is the implication of global utilization of accounting information? In the simplest of terms, users must understand something about how accounting information is prepared to be able to effectively rely on it. What if each country had its own accounting rules? You can see that misinterpretation and lack of understanding could be a real problem. For example, what if a company reported their “turnover” as 10,000,000 euros? What would you conclude? For starters, you would need to know that “turnover” is synonymous with “revenue,” and you would need to know how much a euro is worth. But, my example is not hypothetical; it is real. Terminology and methods are not consistent from country to country. That is why the audit opinion illustrated earlier in this chapter includes a reference to the country of GAAP origin.

Accounting rule makers from around the globe are scrambling to bring about global convergence of accounting techniques. No major country has opted out of this endeavor. The FASB has been working feverishly to rework certain accounting rules to match global approaches. For example, the EPS approach you learned earlier in this chapter was the result of a FASB reworking of the U.S. rules to match the global approach.

The International Accounting Standards Board (IASB) is another important body. It issues its own accounting standards, which in many respects provide a beacon to guide the efforts going on within each country. Countries without their own standard setting body may legitimately expropriate the IASB standards as their own. The IASB membership is broad based, bringing together experts from many countries. Although each contributor to the IASB probably brings ideas to the table with a “home-country” bias, the general tenor has remained one of cooperation toward a shared goal. The IASB maintains an excellent web site (www.IASB.org) if you wish to learn more.

Another useful site to explore global accounting issues is www.accountingeducation. There are many global contributors to that site, and they provide a weekly electronic newsletter that is available at no charge.

7.1 Issues in International Trade

Companies engaging in global business face some specific reporting challenges. Two of those challenges are (1) how to consolidate global subsidiaries and (2) how to account for global transactions denominated in alternative currencies. These subjects quickly become complex, and only a brief introduction to each is appropriate at this time.

7.2 Global Subsidiaries

When a parent corporation has a subsidiary outside of its home country, the financial statements of that subsidiary may be prepared in the "local" currency of the country in which it operates. But, the parent's financials are prepared in the "reporting" currency of the country in which it is domiciled. Thus, to consolidate the parent and sub first requires converting the sub's financial information into the reporting currency. Facts and circumstances will dictate whether the conversion process occurs by a process known as the functional currency translation approach or an alternative approach known as remeasurement:

- Translation is appropriate when the subsidiary is somewhat autonomous. It will be self-supporting by virtue of generating and reinvesting cash flows in its own operations; the parent is primarily an investor. This approach converts the assets and liabilities to the reporting currency based upon prevailing exchange rates at the balance sheet date. A "plug" translation adjustment may be needed to maintain a "balanced" translated set of financials, and that plug is an item of "other comprehensive income" (not operating income).

- Remeasurement would be used when translation is not appropriate (e.g., the subsidiary is a purchasing group established to obtain inventory for the parent). Remeasurement converts assets and liabilities at a variety of exchange rates, depending on the type of asset or liability and the date of its origination. Again, a "plug" may be needed to balance, but this plug will produce a positive (credit) or negative (debit) effect on operating income.

The above discussion is quite oversimplified. Entire chapters in advanced accounting texts are usually devoted to this subject, and even those chapters rarely fully develop the theory and rationale underlying the prescribed mechanics.

7.3 Global Trading Transactions

Many firms buy goods from foreign suppliers and/or sell goods to foreign customers. The terms of the transaction will stipulate how payment is to occur and the currency for making that settlement. If the currency is a "foreign currency," then some additional thought must be given to the associated bookkeeping. Fortunately, this issue is not so complicated and can be easily illustrated with a few examples.

Suppose Bentley's Bike Shop purchases bicycles from GiroCycle of Switzerland. On July 1, 20X6, Bentley purchased 10 bikes, agreeing to pay 20,000 Swiss francs within 60 days. Bentley is in Cleveland, Ohio, and the U.S. dollar is its primary currency. On July 1, Bentley will record the purchase with the following accounts:

7-1-X6	Inventory		?????	
	Accounts Payable			?????
	Purchased bicycles, agreeing to pay 20,000 Swiss francs in 60 days			

But, what amounts should be debited and credited? If 20,000 were used, the accounts would cease to be logical. The total Inventory balance would be illogical since it would include this item, and all other transactions in other currencies, thereby becoming a meaningless hodge-podge of currency units. Total Accounts Payable would become unintelligible as well. Therefore, Bentley needs to measure the transaction in dollars. On July 1, assume that the current exchange rate (i.e., the "spot rate") is $0.75 U.S. dollars to acquire 1 Swiss franc. The correct entry would be:

7-1-X6	Inventory		15,000	
	Accounts Payable			15,000
	Purchased bicycles, agreeing to pay 20,000 Swiss francs in 60 days (spot rate is $0.75: 20,000 X $0.75 = $15,000)			

By the August 29 settlement date, assume that the dollar has weakened and the spot rate is $0.80. Bentley will have to pay a bank $16,000 (20,000 X $0.80) to buy the 20,000 francs needed to settle the obligation. The following entry shows that the difference between the initially recorded payable

($15,000) and the cash settlement amount ($16,000) is to be recorded as a foreign currency transaction loss:

8-29-X6	Accounts Payable		15,000	
	Currency Exchange Loss		1,000	
	Cash			16,000
	Paid foreign currency payable and recorded exchange loss (20,000 Swiss francs X $0.80 = $16,000)			

If the exchange rate had gone the other way to $0.70 by the August 29 settlement date, a foreign currency transaction gain (credit) would have been needed to balance the difference between the $15,000 payable and $14,000 ($0.70 X 20,000) required cash disbursement.

In the preceding example, the foreign currency payable was created and settled within the same accounting period. It is important to know that foreign currency payables and receivables that exist at the close of an accounting period must also be adjusted to reflect the spot on the balance sheet date. The following sale transaction will illustrate this important point.

Suppose Vigeland Corporation sold goods to one of its customers in England, agreeing to accept payment of 100,000 British pounds in 90 days. On the date of sale, December 1, 20X1, the spot rate for the pound was $1.75. Vigeland prepared financial statements at its year end on December 31, 20X1, at which time the spot rate for the pound was $1.90. As expected, the foreign currency receivable was collected on February 28, 20X2; Vigeland immediately converted the 100,000 pounds to dollars at the then current exchange rate of $1.70. The following illustrates the sale, year-end adjustment of the foreign currency receivable, and subsequent collection:

12-1-X1	Accounts Receivable		175,000	
	Sales			175,000
	Sold goods to a customer in England, agreeing to accept 100,000 British pounds (100,000 pounds X $1.75 spot rate = $175,000)			
12-31-X1	Accounts Receivable		15,000	
	Currency Exchange Gain			15,000
	Year-end adjustment to increase accounts receivable to the spot rate (100,000 pounds X $1.90 spot rate = $190,000; $190,000 - $175,000 = $15,000 gain)			
2-28-X2	Cash		170,000	
	Currency Exchange Loss		20,000	
	Accounts Receivable			190,000
	Collected 100,000 pounds and converted them to dollars (100,000 x $1.70 spot rate). Recorded loss for decline in value of receivable since year end ($190,000 vs.$170,000)			

Some companies may wish to avoid foreign currency exchange risks like those illustrated above. The simplest way to avoid such exposure is to convince your trading partner to make or take payment in your home currency. In the alternative, there are various financial agreements that can be structured with banks or others to transfer away this risk (but, forego the opportunity for gains as well). As you might imagine, such hedging transactions can grow quite complex. Great care must be taken to record and monitor these activities, and advanced accounting courses are apt to devote substantial time to this subject.