

Third Edition

# INTERNATIONAL ACCOUNTING



Timothy Doupnik  
Hector Perera

# International Accounting

Third Edition

Timothy Doupnik

*University of South Carolina*



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INTERNATIONAL ACCOUNTING, THIRD EDITION

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# About the Authors

To my wife Birgit and children Stephanie and Alexander

—TSD

To my wife Sujatha and daughter Hasanka

—HBP



# About the Authors

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Timothy S. Douplik is a Professor of Accounting at the University of South Carolina, where he has been on the faculty since 1982, and primarily teaches financial and international accounting. He served as director of the School of Accounting from 2003 until 2010, when he assumed the position of Vice Provost for international affairs. He has an undergraduate degree from California State University-Fullerton, and received his master's and Ph.D. from the University of Illinois.

Professor Douplik has published exclusively in the area of international accounting in various journals, including *The Accounting Review*; *Accounting, Organizations, and Society*; *Abacus*; *Journal of International Accounting Research*; *Journal of Accounting Literature*; *International Journal of Accounting*; and *Journal of International Business Studies*.

Professor Douplik is a past president of the International Accounting Section of the American Accounting Association, and he received the section's Outstanding International Accounting Educator Award in 2008. He has taught or conducted research in the area of international accounting at universities in a number of countries around the world, including Brazil, China, Dominican Republic, Finland, Germany, and Mexico.

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Professor Perera served as chair of the International Relations Committee of the American Accounting Association's International Accounting Section in 2003 and 2004. He is currently an associate editor for the *Journal of International Accounting Research* and on the editorial boards of several other journals.

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# Preface

## ORIENTATION AND UNIQUE FEATURES

International accounting can be viewed in terms of the accounting issues uniquely confronted by companies involved in international business. It also can be viewed more broadly as the study of how accounting is practiced in each and every country around the world, learning about and comparing the differences in financial reporting, taxation, and other accounting practices that exist across countries. More recently, international accounting has come to be viewed as the study of rules and regulations issued by international organizations—most notably International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). This book is designed to be used in a course that attempts to provide an overview of the broadly defined area of international accounting, but that focuses on the accounting issues related to international business activities and foreign operations and provides substantial coverage of the IASB and IFRS.

The unique benefits of this textbook include its up-to-date coverage of relevant material; extensive numerical examples provided in most chapters; two chapters devoted to the application of International Financial Reporting Standards (IFRS); and coverage of nontraditional but important topics such as strategic accounting issues of multinational companies, international corporate governance, and corporate social reporting. This book contains several important distinguishing features:

- Numerous excerpts from recent annual reports to demonstrate differences in financial reporting practices across countries and to demonstrate financial reporting issues especially relevant for multinational corporations.
- Incorporation of research findings into the discussion on many issues.
- Extensive end-of-chapter assignments that help students develop their analytical, communication, and research skills.
- Detailed discussion on the most recent developments in the area of international harmonization/convergence of financial reporting standards.
- Two chapters on International Financial Reporting Standards that provide detailed coverage of a wide range of standards and topics. One chapter focuses on the financial reporting of assets, and the second chapter focuses on liabilities, financial instruments, and revenue recognition. (IFRS related to topics such as business combinations, foreign currency, and segment reporting are covered in other chapters.) The IFRS chapters also include numerical examples demonstrating major differences between IFRS and U.S. GAAP and their implications for financial statements.
- Separate chapters for foreign currency transactions and hedging foreign exchange risk and translation of foreign currency financial statements. The first of these chapters includes detailed examples demonstrating the accounting for foreign currency derivatives used to hedge a variety of types of foreign currency exposure.
- Separate chapters for international taxation and international transfer pricing, with detailed examples based on provisions in U.S. tax law.

- A chapter devoted to a discussion of the strategic accounting issues facing multinational corporations, with a focus on the role accounting plays in strategy formulation and implementation.
- Use of a corporate governance framework to cover external and internal auditing issues in an international context, with substantial coverage of the Sarbanes-Oxley Act of 2002.
- A new chapter on corporate social responsibility reporting, which is becoming increasingly more common among global enterprises.

## CHAPTER-BY-CHAPTER CONTENT

Chapter 1 introduces the accounting issues related to international business by following the evolution of a fictional company as it grows from a domestic company to a global enterprise. This chapter provides the context into which the topics covered in the remaining chapters can be placed.

Chapters 2 and 3 focus on differences in financial reporting across countries and the international convergence of accounting standards.

- Chapter 2 presents evidence of the diversity in financial reporting that exists around the world, explores the reasons for that diversity, and describes the problems that are created by differences in accounting practice across countries. In this chapter, we also describe and compare several major models of accounting used internationally. We discuss the potential impact that culture has on the development of national accounting systems and present a simplified model of the reasons for international differences in financial reporting. The final section of this chapter uses excerpts from recent annual reports to present additional examples of some of the differences in accounting that exist across countries.
- Chapter 3 focuses on the major efforts worldwide to converge financial reporting practices with an emphasis on the activities of the International Accounting Standards Board (IASB). We explain the meaning of convergence, identify the arguments for and against convergence, and discuss the use of the IASB's International Financial Reporting Standards (IFRS), including national efforts to converge with those standards.

The almost universal recognition of IFRS as a high-quality set of global accounting standards is arguably the most important development in the world of international accounting. Chapters 4 and 5 introduce financial reporting under IFRS for a wide range of accounting issues.

- Chapter 4 summarizes the major differences between IFRS and U.S. GAAP. It provides detailed information on selected IFRS, concentrating on standards that relate to the recognition and measurement of assets—including inventories; property, plant, and equipment; intangible assets; and leased assets. Numerical examples demonstrate the application of IFRS, differences between IFRS and U.S. GAAP, and the implications for financial statements. This chapter also describes the requirements of IFRS in a variety of disclosure and presentation standards.
- Chapter 5 focuses on current liabilities, provisions, employee benefits, share-based payment, income taxes, revenue, and financial instruments, including major differences between IFRS and U.S. GAAP.

Chapter 6 describes the accounting environment in five economically significant countries—China, Germany, Japan, Mexico, and the United Kingdom—that are representative of major clusters of accounting system. The discussion related to each country's accounting system is organized into four parts: background, accounting profession, accounting regulation, and accounting principles and practices. Exhibits throughout the chapter provide detailed information on differences between each country's GAAP and IFRS, as well as reconciliations from local GAAP to U.S. GAAP.

Chapters 7, 8, and 9 deal with financial reporting issues that are of particular importance to multinational corporations. Two different surveys of business executives indicate that the most important topics that should be covered in an international accounting course are related to the accounting for foreign currency.<sup>1</sup> Because of its importance, this topic is covered in two separate chapters (Chapters 7 and 8). Chapter 9 covers three additional financial reporting topics of particular importance to multinational corporations—inflation accounting, business combinations and consolidated financial statements, and segment reporting. Emphasis is placed on understanding IFRS related to these topics.

- Chapter 7 begins with a description of the foreign exchange market and then demonstrates the accounting for foreign currency transactions. Much of this chapter deals with the accounting for derivatives used in foreign currency hedging activities. We first describe how foreign currency forward contracts and foreign currency options can be used to hedge foreign exchange risk. We then explain the concepts of cash flow hedges, fair value hedges, and hedge accounting. Finally, we demonstrate the accounting for forward contracts and options used as cash flow hedges and fair value hedges to hedge foreign currency assets and liabilities, foreign currency firm commitments, and forecasted foreign currency transactions.
- Chapter 8 focuses on the translation of foreign currency financial statements for the purpose of preparing consolidated financial statements. We begin by examining the conceptual issues related to translation, focusing on the concept of balance sheet exposure and the economic interpretability of the translation adjustment. Only after a thorough discussion of the concepts and issues do we then describe the manner in which these issues have been addressed by the IASB and by the U.S. FASB. We then illustrate application of the two methods prescribed by both standard-setters and compare the results. We discuss the hedging of balance sheet exposure and provide examples of disclosures related to translation.
- Chapter 9 covers three additional financial reporting issues. The section on inflation accounting begins with a conceptual discussion of asset valuation and capital maintenance through the use of a simple numerical example and then summarizes the inflation accounting methods used in different countries. The second section focuses on International Financial Reporting Standards related to business combinations and consolidations, covering issues such as the determination of control, the acquisition method, proportionate consolidation, and

<sup>1</sup> T. Conover, S. Salter, and J. Price, "International Accounting Education: A Comparison of Course Syllabi and CFO Preferences," *Issues in Accounting Education*, Fall 1994; and T. Foroughi and B. Reed, "A Survey of the Present and Desirable International Accounting Topics in Accounting Education," *International Journal of Accounting*, Fall 1987, pp. 64–82.



the equity method. The final section of this chapter focuses on International Financial Reporting Standard 8, *Operating Segments*.

Chapter 10 introduces issues related to the analysis of foreign financial statements. We explore potential problems (and possible solutions to those problems) associated with using the financial statements of foreign companies for decision-making purposes. This chapter also provides an example of how an analyst would reformat and restate financial statements from one set of GAAP to another.

Business executives rank international taxation second only to foreign currency in importance as a topic to be covered in an international accounting course.<sup>2</sup> International taxation and tax issues related to international transfer pricing are covered in Chapters 11 and 12.

- Chapter 11 focuses on the taxation of foreign operation income by the home-country government. Much of this chapter deals with foreign tax credits, the most important mechanism available to companies to reduce double taxation. This chapter provides a comprehensive example demonstrating the major issues involved in U.S. taxation of foreign operation income. We also discuss benefits of tax treaties, translation of foreign currency amounts for tax purposes, and tax incentives provided to attract foreign investment.
- Chapter 12 covers the topic of international transfer pricing, focusing on tax implications. We explain how discretionary transfer pricing can be used to achieve specific cost minimization objectives and how the objectives of performance evaluation and cost minimization can conflict in determining international transfer prices. We also describe government reactions to the use of discretionary transfer pricing by multinational companies, focusing on the U.S. rules governing intercompany pricing.

Chapter 13 covers strategic accounting issues of particular relevance to multinational corporations. This chapter discusses multinational capital budgeting as a vital component of strategy formulation and operational budgeting as a key ingredient in strategy implementation. Chapter 13 also deals with issues that must be addressed in designing a process for evaluating the performance of foreign operations.

Chapter 14 covers comparative international auditing and corporate governance. This chapter discusses both external and internal auditing issues as they relate to corporate governance in an international context. Chapter 14 also describes international diversity in external auditing and the international harmonization of auditing standards.

Chapter 15 introduces the current trend toward corporate social reporting (CSR) by multinational corporations (MNCs). We describe theories often used to explain CSR practices by companies and the motivations for them to engage in CSR practices. We also examine the implications of climate change for CSR. Further, we discuss some issues associated with regulation of CSR at the international level and identify international organizations that promote CSR, such as Global Reporting Initiative (GRI). Finally, we provide examples of actual CSR practices by MNCs.

<sup>2</sup> Ibid.

## SUPPLEMENTARY MATERIAL

*International Accounting* is accompanied by supplementary items for both students and instructors. The Online Learning Center ([www.mhhe.com/doupnik3e](http://www.mhhe.com/doupnik3e)) is a book-specific website that includes the following supplementary materials.

### For Students:

- Chapter Summaries
- Learning Objectives
- Links to Relevant Sites
- Online Quizzing

### For Instructors:

- Access to all supplementary materials for students
- Instructor's Manual
- Solutions Manual
- PowerPoint Presentations
- Test Bank

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# Brief Contents

About the Authors iv

Preface v

## Chapter

- 1 Introduction to International Accounting 1
- 2 Worldwide Accounting Diversity 23
- 3 International Convergence of Financial Reporting 65
- 4 International Financial Reporting Standards: Part I 114
- 5 International Financial Reporting Standards: Part II 175
- 6 Comparative Accounting 233
- 7 Foreign Currency Transactions and Hedging Foreign Exchange Risk 339
- 8 Translation of Foreign Currency Financial Statements 403
- 9 Additional Financial Reporting Issues 449
- 10 Analysis of Foreign Financial Statements 493
- 11 International Taxation 543
- 12 International Transfer Pricing 588
- 13 Strategic Accounting Issues in Multinational Corporations 623
- 14 Comparative International Auditing and Corporate Governance 679
- 15 International Corporate Social Reporting 744



# Contents

## About the Authors iv

## Preface v

## Chapter 1

### Introduction to International Accounting 1

- What Is International Accounting? 1
- Evolution of a Multinational Corporation 2
  - Sales to Foreign Customers* 2
  - Hedges of Foreign Exchange Risk* 4
  - Foreign Direct Investment* 4
  - Financial Reporting for Foreign Operations* 6
  - International Income Taxation* 7
  - International Transfer Pricing* 7
  - Performance Evaluation of Foreign Operations* 8
  - International Auditing* 8
  - Cross-Listing on Foreign Stock Exchanges* 9
  - Global Accounting Standards* 10
- The Global Economy 10
  - International Trade* 10
  - Foreign Direct Investment* 11
  - Multinational Corporations* 12
  - International Capital Markets* 14
- Outline of the Book 14
- Summary 15
- Questions 16
- Exercises and Problems 17
- Case 1-1: Besserbrau AG 19
- Case 1-2: Vanguard International Growth Fund 19
- References 22

## Chapter 2

### Worldwide Accounting Diversity 23

- Introduction 23
- Evidence of Accounting Diversity 24
- Reasons for Accounting Diversity 28
  - Legal System* 28
  - Taxation* 29
  - Providers of Financing* 29
  - Inflation* 30
  - Political and Economic Ties* 30
  - Correlation of Factors* 30

### Problems Caused by Accounting Diversity 31

- Preparation of Consolidated Financial Statements* 31
- Access to Foreign Capital Markets* 31
- Comparability of Financial Statements* 32
- Lack of High-Quality Accounting Information* 33
- Accounting Clusters 33
  - A Judgmental Classification of Financial Reporting Systems* 34
- An Empirical Test of the Judgmental Classification 35
- The Influence of Culture on Financial Reporting 37
  - Hofstede's Cultural Dimensions* 37
  - Gray's Accounting Values* 37
  - Religion and Accounting* 39
- A Simplified Model of the Reasons for International Differences in Financial Reporting 41
  - Examples of Countries with Class A Accounting* 42
  - Recent Changes in Europe* 42
- Further Evidence of Accounting Diversity 43
  - Financial Statements* 43
  - Format of Financial Statements* 43
  - Level of Detail* 47
  - Terminology* 47
  - Disclosure* 49
  - Recognition and Measurement* 53
- Summary 54
- Appendix to Chapter 2**
- The Case of Daimler-Benz 55**
- Questions 57
- Exercises and Problems 58
- Case 2-1: The Impact of Culture on Conservatism 60
- Case 2-2: SKD Limited 62
- References 63

## Chapter 3

### International Convergence of Financial Reporting 65

- Introduction 65
- Convergence as the Buzz Word in International Financial Reporting 66

Major Harmonization Efforts	67
<i>International Organization of Securities Commissions</i>	67
<i>International Federation of Accountants</i>	68
<i>European Union</i>	68
The International Accounting Standards Committee	71
<i>The "Lowest-Common-Denominator" Approach</i>	71
<i>The Comparability Project</i>	71
<i>The IOSCO Agreement</i>	72
<i>U.S. Reaction to International Accounting Standards</i>	72
<i>Compliance with International Accounting Standards</i>	73
Creation of the IASB	74
<i>The Structure of the IASB</i>	74
The IASB Framework	80
<i>The Need for a Framework</i>	80
<i>Objective of Financial Statements and Underlying Assumptions</i>	81
<i>Qualitative Characteristics of Financial Statements</i>	81
<i>Elements of Financial Statements: Definition, Recognition, and Measurement</i>	81
<i>Concepts of Capital Maintenance</i>	82
<i>Revision of the Conceptual Framework</i>	82
International Financial Reporting Standards	85
A Principles-Based Approach to International Financial Reporting Standards	88
Presentation of Financial Statements (IAS 1)	88
First-Time Adoption of International Financial Reporting Standards (IFRS 1)	90
Arguments for and against International Convergence of Financial Reporting Standards	92
<i>Arguments for Convergence</i>	92
<i>Arguments against Convergence</i>	93
International Convergence toward IFRS	93
The Adoption of International Financial Reporting Standards	96
IFRS in the European Union	98
IFRS in the United States	100
<i>Support for a Principles-Based Approach</i>	100
<i>The Norwalk Agreement</i>	101
<i>The SEC's Policy on IFRS</i>	103
Some Concluding Remarks	104
Summary	104
<b>Appendix to Chapter 3</b>	
<b>What Is This Thing Called Anglo-Saxon Accounting?</b>	106
Questions	108
Exercises and Problems	108
Case 3-1: Jardine Matheson Group (Part 1)	111
References	112
<b>Chapter 4</b>	
<b>International Financial Reporting Standards: Part I</b>	114
Introduction	114
Types of Differences between IFRS and U.S. GAAP	115
Inventories	116
<i>Lower of Cost or Net Realizable Value</i>	117
Property, Plant, and Equipment	118
<i>Recognition of Initial and Subsequent Costs</i>	119
<i>Measurement at Initial Recognition</i>	119
<i>Measurement Subsequent to Initial Recognition</i>	120
<i>Depreciation</i>	126
<i>Derecognition</i>	126
Investment Property	127
Impairment of Assets	127
<i>Definition of Impairment</i>	127
<i>Measurement of Impairment Loss</i>	128
<i>Reversal of Impairment Losses</i>	129
Intangible Assets	130
<i>Purchased Intangibles</i>	131
<i>Intangibles Acquired in a Business Combination</i>	132
<i>Internally Generated Intangibles</i>	132
<i>Revaluation Model</i>	137
<i>Impairment of Intangible Assets</i>	137
Goodwill	137
<i>Impairment of Goodwill</i>	138
<i>Goodwill Not Allocable to Cash-Generating Unit under Review</i>	140
Borrowing Costs	142
Leases	143
<i>Lease Classification</i>	143
<i>Finance Leases</i>	145
<i>Operating Leases</i>	146
<i>Sale-Leaseback Transaction</i>	146
<i>Disclosure</i>	147
<i>IASB/FASB Convergence Project</i>	149
<i>Other Recognition and Measurement Standards</i>	149
Disclosure and Presentation Standards	150
<i>Statement of Cash Flows</i>	150
<i>Events after the Reporting Period</i>	151
<i>Accounting Policies, Changes in Accounting Estimates and Errors</i>	152
<i>Related Party Disclosures</i>	153
<i>Earnings per Share</i>	153
<i>Interim Financial Reporting</i>	154

Noncurrent Assets Held for Sale and Discontinued Operations	154
Operating Segments	154
Summary	155
Questions	157
Exercises and Problems	158
Case 4-1: Bessrawl Corporation	173
References	174

## Chapter 5

### International Financial Reporting Standards: Part II 175

Introduction	175
Current Liabilities	175
Provisions, Contingent Liabilities, and Contingent Assets	176
Contingent Liabilities and Provisions	176
Onerous Contract	178
Restructuring	179
Contingent Assets	179
Additional Guidance	180
Proposed Amendments to IAS 37	180
Employee Benefits	181
Short-Term Benefits	182
Post-employment Benefits	182
Other Long-Term Employee Benefits	188
Termination Benefits	188
Share-Based Payment	188
Equity-Settled Share-Based Payment Transactions	189
Cash-Settled Share-Based Payment Transactions	190
Choice-of-Settlement Share-Based Payment Transactions	191
Income Taxes	193
Tax Laws and Rates	193
Recognition of Deferred Tax Asset	194
Disclosures	195
IFRS versus U.S. GAAP	195
Financial Statement Presentation	196
Revenue Recognition	197
General Measurement Principle	197
Identification of the Transaction Generating Revenue	197
Sale of Goods	197
Rendering of Services	199
Interest, Royalties, and Dividends	200
Exchanges of Goods or Services	200
IAS 18, Part B	200
Customer Loyalty Programs	201
Construction Contracts	202
IASB—FASB Revenue Recognition Project	203

### Financial Instruments 204

Definitions	205
Liability or Equity	206
Compound Financial Instruments	206
Classification of Financial Assets and Financial Liabilities	207
Measurement of Financial Instruments	209
Available-for-Sale Financial Asset Denominated in a Foreign Currency	211
Impairment	212
Derecognition	212
Derivatives	214
Receivables	214
Summary	216
Questions	218
Exercises and Problems	219
Case 5-1: S. A. Harrington Company	231

## Chapter 6

### Comparative Accounting 233

Introduction	233
People's Republic of China (PRC)	235
Background	235
Accounting Profession	237
Accounting Regulation	242
Accounting Principles and Practices	245
Germany	254
Background	254
Accounting Profession	255
Accounting Regulation	255
Accounting Principles and Practices	258
Japan	271
Background	271
Accounting Profession	273
Accounting Regulation	273
Accounting Principles and Practices	277
Mexico	281
Background	281
Accounting Profession	282
Accounting Regulation	283
Accounting Principles and Practices	285
United Kingdom	308
Background	308
Accounting Profession	308
Accounting Regulation	310
Accounting Principles and Practices	313
Summary	326
Questions	328
Exercises and Problems	328

Case 6-1: China Petroleum and Chemical Corporation	330
References	336

## Chapter 7

### Foreign Currency Transactions and Hedging Foreign Exchange Risk 339

Introduction	339
Foreign Exchange Markets	340
<i>Exchange Rate Mechanisms</i>	340
<i>Foreign Exchange Rates</i>	341
<i>Spot and Forward Rates</i>	343
<i>Option Contracts</i>	344
Foreign Currency Transactions	344
<i>Accounting Issue</i>	345
<i>Accounting Alternatives</i>	345
<i>Balance Sheet Date before Date of Payment</i>	347
Hedging Foreign Exchange Risk	349
Accounting for Derivatives	350
<i>Fundamental Requirement of Derivatives Accounting</i>	351
<i>Determining the Fair Value of Derivatives</i>	351
<i>Accounting for Changes in the Fair Value of Derivatives</i>	352
Hedge Accounting	352
<i>Nature of the Hedged Risk</i>	352
<i>Hedge Effectiveness</i>	353
<i>Hedge Documentation</i>	353
Hedging Combinations	353
Hedges of Foreign-Currency-Denominated Assets and Liabilities	354
Forward Contract Used to Hedge a Recognized Foreign-Currency-Denominated Asset	355
<i>Forward Contract Designated as Cash Flow Hedge</i>	357
<i>Forward Contract Designated as Fair Value Hedge</i>	361
Foreign Currency Option Used to Hedge a Recognized Foreign-Currency-Denominated Asset	363
<i>Option Designated as Cash Flow Hedge</i>	365
<i>Spot Rate Exceeds Strike Price</i>	367
<i>Option Designated as Fair Value Hedge</i>	368
Hedges of Unrecognized Foreign Currency Firm Commitments	368
<i>Forward Contract Used as Fair Value Hedge of a Firm Commitment</i>	368
<i>Option Used as Fair Value Hedge of Firm Commitment</i>	371
Hedge of Forecasted Foreign-Currency-Denominated Transaction	373
<i>Option Designated as a Cash Flow Hedge of a Forecasted Transaction</i>	374

Use of Hedging Instruments	375
<i>The Euro</i>	377

Foreign Currency Borrowing	377
----------------------------	-----

<i>Foreign Currency Loan</i>	379
------------------------------	-----

Summary	379
---------	-----

## Appendix to Chapter 7

### Illustration of the Accounting for Foreign Currency Transactions and Hedging Activities by an Importer 380

Questions	392
-----------	-----

Exercises and Problems	393
------------------------	-----

Case 7-1: Zorba Company	401
-------------------------	-----

Case 7-2: Portofino Company	402
-----------------------------	-----

Case 7-3: Better Food Corporation	402
-----------------------------------	-----

References	402
------------	-----

## Chapter 8

### Translation of Foreign Currency Financial Statements 403

Introduction	403
--------------	-----

Two Conceptual Issues	404
-----------------------	-----

<i>Example</i>	404
----------------	-----

<i>Balance Sheet Exposure</i>	407
-------------------------------	-----

Translation Methods	408
---------------------	-----

<i>Current/Noncurrent Method</i>	408
----------------------------------	-----

<i>Monetary/Nonmonetary Method</i>	408
------------------------------------	-----

<i>Temporal Method</i>	409
------------------------	-----

<i>Current Rate Method</i>	410
----------------------------	-----

<i>Translation of Retained Earnings</i>	411
---	-----

<i>Complicating Aspects of the Temporal Method</i>	413
--	-----

Disposition of Translation Adjustment	414
---------------------------------------	-----

U.S. GAAP	415
-----------	-----

<i>FASB ASC 830</i>	416
---------------------	-----

<i>Functional Currency</i>	416
----------------------------	-----

<i>Highly Inflationary Economies</i>	417
--------------------------------------	-----

International Financial Reporting Standards	418
---	-----

The Translation Process Illustrated	420
-------------------------------------	-----

Translation of Financial Statements: Current Rate Method	421
--	-----

<i>Translation of the Balance Sheet</i>	422
---	-----

<i>Computation of Translation Adjustment</i>	424
--	-----

Remeasurement of Financial Statements:	
--	--

Temporal Method	424
-----------------	-----

<i>Remeasurement of Income Statement</i>	424
--	-----

<i>Computation of Remeasurement Gain</i>	426
--	-----

Comparison of the Results from Applying the	
---	--

Two Different Methods	427
-----------------------	-----

<i>Underlying Valuation Method</i>	428
------------------------------------	-----

<i>Underlying Relationships</i>	428
---------------------------------	-----

Hedging Balance Sheet Exposure	429
--------------------------------	-----

Disclosures Related to Translation	430
------------------------------------	-----



Summary	434
Questions	435
Exercises and Problems	436
Case 8-1: Columbia Corporation	443
Case 8-2: Palmerstown Company	445
Case 8-3: BellSouth Corporation	447
References	448

## Chapter 9

### Additional Financial Reporting Issues 449

Introduction	449
Accounting for Changing Prices (Inflation Accounting)	450
<i>Impact of Inflation on Financial Statements</i>	450
<i>Purchasing Power Gains and Losses</i>	451
<i>Methods of Accounting for Changing Prices</i>	451
<i>General Purchasing Power (GPP) Accounting</i>	453
<i>Current Cost (CC) Accounting</i>	454
<i>Inflation Accounting Internationally</i>	455
<i>International Financial Reporting Standards</i>	458
<i>Translation of Foreign Currency Financial Statements in Hyperinflationary Economies</i>	461
Business Combinations and Consolidated Financial Statements	464
<i>Determination of Control</i>	465
<i>Scope of Consolidation</i>	468
<i>Full Consolidation</i>	468
<i>Proportionate Consolidation</i>	472
<i>Equity Method</i>	473
Segment Reporting	475
<i>Operating Segments—The Management Approach</i>	476
<i>Example: Application of Significance Tests</i>	477
<i>Operating Segment Disclosures</i>	478
<i>Entity-Wide Disclosures</i>	479
Summary	483
Questions	484
Exercises and Problems	484
References	492

## Chapter 10

### Analysis of Foreign Financial Statements 493

Introduction	493
Overview of Financial Statement Analysis	493
Reasons to Analyze Foreign Financial	

Statements	495
<i>Foreign Portfolio Investment</i>	495
<i>International Mergers and Acquisitions</i>	495
<i>Other Reasons</i>	496
Potential Problems in Analyzing Foreign Financial Statements	496
<i>Data Accessibility</i>	496
<i>Language</i>	497
<i>Currency</i>	498
<i>Terminology</i>	500
<i>Format</i>	501
<i>Extent of Disclosure</i>	501
<i>Timeliness</i>	504
<i>Differences in Accounting Principles</i>	505
<i>International Ratio Analysis</i>	508
Restating Financial Statements	510
<i>Explanation of Reconciling Adjustments</i>	515
<i>Comparison of Local GAAP and U.S. GAAP</i>	
<i>Amounts</i>	520
Summary	521
Appendix to Chapter 10	
Morgan Stanley Dean Witter: <i>Apples to Apples</i>	522
Questions	525
Exercises and Problems	525
Case 10-1: Swisscom AG	537
References	541

## Chapter 11

### International Taxation 543

Introduction	543
<i>Investment Location Decision</i>	543
<i>Legal Form of Operation</i>	544
<i>Method of Financing</i>	544
Types of Taxes and Tax Rates	544
<i>Income Taxes</i>	544
<i>Tax Havens</i>	546
<i>Withholding Taxes</i>	548
<i>Tax-Planning Strategy</i>	549
<i>Value-Added Tax</i>	549
Tax Jurisdiction	550
<i>Worldwide versus Territorial Approach</i>	550
<i>Source, Citizenship, and Residence</i>	551
<i>Double Taxation</i>	552
Foreign Tax Credits	553
<i>Credit versus Deduction</i>	553
<i>Calculation of Foreign Tax Credit</i>	554
<i>Excess Foreign Tax Credits</i>	555