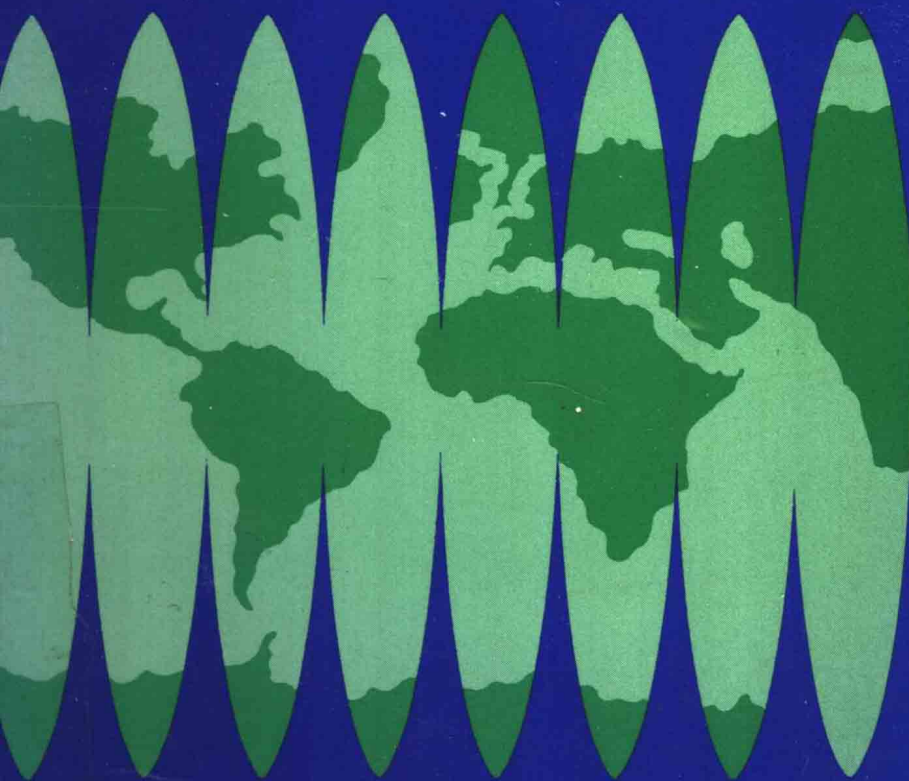


# INTERNATIONAL Dimensions of Accounting

Jeffrey S. Arpan  
Dhia D. AlHashim



The Kent International Business Series

# **INTERNATIONAL DIMENSIONS OF ACCOUNTING**

Jeffrey S. Arpan

*University of South Carolina*

Dhia D. AlHashim

*California State University, Northridge*

This book is dedicated  
to Kathy and Shatha

Editor: John B. McHugh  
Production Editor: Michael Paladini  
Cover and Text Designer: Armen Kojoyian  
Production Coordinator: Linda Siegrist

Kent Publishing Company  
A Division of Wadsworth, Inc.

© 1984 by Wadsworth, Inc., 10 Davis Drive, Belmont, California 94002.  
All rights reserved. No part of this book may be reproduced, stored  
in a retrieval system, or transcribed, in any form or by any means,  
electronic, mechanical, photocopying, recording, or otherwise, without  
the prior written permission of the publisher, Kent Publishing Company,  
20 Park Plaza, Boston, Massachusetts 02116.

Printed in the United States of America

3 4 5 6 7 8 9—87

#### Library of Congress Cataloging in Publication Data

Arpan, Jeffrey S.

The international dimensions of accounting.

(The International dimensions of business)

Includes bibliographical references and index.

1. International business enterprises—Accounting.

2. Accounting. I. AlHashim, Dhia D. II. Title.

III. Series.

HF5686.156A77 1983

657 .95

83-18747

ISBN 0-534-01467-4

# Series Foreword

Prior to World War II, the number of firms involved in foreign direct investment was relatively small. Although several U.S. companies were obtaining raw materials from other countries, most firms were only interested in the U.S. market. This changed, however, during the 1950s—especially after the creation of the European Economic Community. Since that time, there has been a rapid expansion in international business activity.

The majority of the world's large corporations now perform an increasing proportion of their business activities outside of their home country. For many of these companies, international business returns over one-half of their profits, and it is becoming more and more common for a typical corporation to earn at least one-fourth of its profits through international business involvement. In fact, it is now rather rare for any large firm not to be a participant in the world of international business.

International business is of great importance in most countries and that importance continues to grow. To meet the demand for increased knowledge in this area, business schools are attempting to add international dimensions to their curricula. Faculty members are becoming more interested in teaching a greater variety of international business courses and are striving to add international dimensions to other courses. Students, aware of the increasing probability that they will be employed by firms engaged in international business activities, are seeking knowledge of the problem-solving techniques unique to international business. As the American Assembly of Collegiate Schools of Business has observed, however, there is a shortage of information available. Most business textbooks do not adequately consider the international dimensions of business

## SERIES FOREWORD

and much of the supplemental material is disjointed, overly narrow or otherwise inadequate in the classroom.

This series has been developed to overcome such problems. The books are written by some of the most respected authors in the various areas of international business. Each author is extremely well known in the Academy of International Business and in his other professional academies. Each possesses an outstanding knowledge of his subject matter and a talent for explaining it.

These books, in which the authors have identified the most important international aspects of their fields, have been written in a format which facilitates their use as supplemental material in business school courses. For the most part, the material is presented by topic in approximately the same order and manner as it is covered in basic business textbooks. Therefore, as each topic is covered in the course, material is easily supplemented with the corresponding chapter in the series book.

The Kent Series in International Business offers a unique and much needed opportunity to bring international dimensions of business into the classroom. The series has been developed by leaders in the field after years of discussion and careful consideration, and the timely encouragement and support provided by Keith Nave, Kent Senior Editor on this project. I am proud to be associated with this series and highly recommend it to you.

David A. Ricks

*Consulting Editor to the  
Kent Series in International Business  
Professor of International Business,  
University of South Carolina*

# Preface

Although Wendell Willkie many decades ago spoke euphemistically about “one world,” really only within the last ten years has the true meaning of “one world” become economically clear for most people. In the U.S., no home seems complete without a Japanese television, clothing from France or Hong Kong, or an imported car. Similarly, consumers in other countries drink Coca Cola, have G.E. kitchen appliances, wear Levi’s jeans, and eat Kentucky Fried Chicken. The same sort of economic internationalization has occurred throughout the world’s business communities. Foreign firms use U.S.-made computers, American auto firms use foreign-made components, and nearly every country uses Middle Eastern oil. In addition, U.S. firms have investments in other countries, and vice versa.

Increasing international trade of products, services, technology, and expertise, as well as increasing foreign investment, both in and by foreign countries, have been the driving forces of internationalization. Behind the expansion of international business there is the common desire in countries to upgrade their standards of living, even as they face domestic shortages of the means to do so. In short, similar aspirations but different capabilities have resulted in an increasingly interwoven world, even in spite of several strong feelings, such as intense nationalism, that would impede the process.

## PREFACE

No matter what its cause or desirability, the rapid expansion of international business activity has led to new problems and challenges for the accounting, business, and financial communities. These problems include, first, simply doing business internationally, and, second, providing information and services to firms that do, and to those people who invest in, loan money to, or otherwise interact with firms operating internationally.

In fact, the common denominator of the problems associated with doing business internationally is the proper generation and interpretation of internationally related information. Old methods of accounting and financial analysis are no longer adequate. Flows of goods, services, and capital across national borders have generated the “international” dimensions of accounting. That is, accounting procedures and analysis have been forced to take into account new types of transactions, events, and relationships hitherto largely ignored, such as the changes in the exchange value of a currency and their impact on corporate earnings. Without such adaptations and modifications, users of accounting information could be easily misled without knowing it, and hence, they would not make the proper decisions.

The purpose of this book is to identify and explain several major aspects of accounting’s international dimensions. It is intended as a supplementary text for undergraduate and graduate courses in accounting, and as a text for professional accountants and financial executives as well. It cannot and does not cover *all* aspects of international accounting. Rather, more than anything else, this text seeks to increase the reader’s awareness, and to extend his or her horizons beyond purely domestic accounting.

## ORGANIZATION AND USE OF THE TEXT

These pages encompass the major international dimensions of financial accounting, managerial accounting, and auditing, and also include information about the accounting profession in various countries. Because few accounting courses cover all of these four areas, certain chapters of *International Dimensions of Accounting* will not be appropriate for some classes. In addition, this book assumes that the reader is already familiar with domestic accounting principles and procedures. Therefore, *International Dimensions of Accounting* is best suited for use after specific domestic situations have been covered.

Chapter 1 provides an overview of the need for international skills,

## PREFACE

an explanation of why accounting and accountants are different in different countries, and a discussion of some of the special problems that these differences pose for multinational enterprises.

Chapter 2 covers the methods by which accounting standards are established in various countries, and why particular methods are chosen or necessitated. The specific countries discussed are Brazil, France, Germany, Japan, the Netherlands, Switzerland, the United Kingdom, and the United States. The chapter also describes the progress of efforts to lessen differences in accounting practices around the world.

Chapter 3 provides a general discussion of the difficulties encountered in analyzing foreign financial statements, and focuses on both the differences of valuation and income determination procedures and cosmetic differences of style and format. It also highlights the shortcomings of using the techniques of financial analysis developed in one country on the financial statements from another country.

Chapter 4 continues the general subject of valuation and income determination begun in Chapter 3. However, its focus is entirely on inflation accounting—a subject too lengthy to cover adequately as part of Chapter 3. Chapter 4 covers the basic theoretical approaches to inflation accounting as well as describing the specific approaches taken in Germany, France, Chile, the Netherlands, Brazil, and the United Kingdom (with comparisons to the United States).

Chapters 5, 6, and 7 contain material more directly related to the operational accounting aspects of multinational firms. Chapter 5 deals with several major financial reporting issues, such as consolidation, foreign exchange gains and losses due to transactions and translation, segment reporting, and social accounting. Chapter 6 covers the major international aspects of managerial accounting, such as planning and budgeting, investment analysis, product costing, performance evaluation, and control processes. Finally, Chapter 7 covers the international aspects of auditing, both internal and external, including the accounting implications of the Foreign Corrupt Practices Act and a description of the activities of international public accounting firms. It also contains some information about the auditing profession and its standards in several countries.

## ACKNOWLEDGEMENTS

We are grateful for all those pioneers in the field of international accounting without whom interest in this field would not have material-



## PREFACE

ized, and especially for the efforts of S. Paul Garner, Emeritus Dean of the University of Alabama, Vernon K. Zimmerman of the University of Illinois, and Gerhard G. Mueller of the University of Washington.

The authors acknowledge the constructive comments of the reviewers of the manuscript of this text, Professor Irving L. Fantl of Florida International University, and Professor Lee H. Radebaugh of Brigham Young University. We also wish to thank Michael Paladini for his skillful copyediting of the manuscript.

Finally, we assume responsibility for whatever weaknesses may be present in *International Dimensions of Accounting*. Readers' comments on this text would be gratefully appreciated.

Jeffrey S. Arpan  
Dhia D. AlHashim

Columbia, South Carolina  
Northridge, California  
1983

# Contents

## **Chapter 1: Introduction and Overview 1**

Environmental Influences on Accounting 4

The Accounting Profession Worldwide 9

Special Accounting Problems for Multinational Enterprises 14

Study Questions for Chapter 1 16

Additional References 16

## **Chapter 2: Accounting Policy Formulation 18**

Financial Regulation in the United States 19

Financial Regulation in the United Kingdom 21

Financial Regulation in Brazil 23

Financial Regulation in France 25

Financial Regulation in Germany 27

Financial Regulation in Japan 29

Financial Regulation in the Netherlands 31

Financial Regulation in Switzerland 33

The Harmonization of Accounting 35

Study Questions for Chapter 2 56

Additional References 57

### **Chapter 3: Income Determination and Financial Analysis 59**

Valuation and Income Determination 60

Financial Analysis 66

Study Questions for Chapter 3 94

Additional References 94

### **Chapter 4: Inflation Accounting 96**

Worldwide Inflation and Financial Reporting 96

Application of Inflation Accounting in Selected Countries 102

Summary and Conclusion 113

Appendix 114

Appendix Continued: Explanatory Notes to the Combined Statements  
of the Philips Company 115

Study Questions for Chapter 4 118

Additional References 119

### **Chapter 5: Financial Reporting in Multinational Enterprises 121**

Gains and Losses from Exchange Rate Changes 122

The Methods of Translation 129

Consolidation Problems 139

Disclosure 144

Summary 154

Study Questions for Chapter 5 154

Additional References 155

**Chapter 6: Managerial Accounting Complexities  
in International Business 158**

Planning	159
Costing	165
Control	170
Organizing	178
Summary	180
Study Questions for Chapter 6	180
Additional References	181

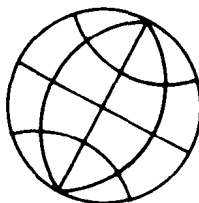
**Chapter 7: Auditing 183**

Internal Auditing	184
External Auditing	192
The International Harmonization of Auditing Standards	199
Summary and Conclusions	203
Study Questions for Chapter 7	203
Additional References	204

**Epilogue 206**

**Index 209**

# Chapter 1



## Introduction and Overview

Due to the explosive growth of international business over the last two decades, increasing attention necessarily has been paid to the international problems of accounting. A few statistics provide an indication of the *magnitude of recent international business transactions*. During the last two decades, the direct investment of U.S. companies abroad more than tripled, increasing from about \$52 billion in 1966 to over \$170 billion in 1979. In the other direction, the increase was even more marked. The direct investment of foreign-based companies in the U.S. increased from \$9 billion in 1966 to about \$41 billion in 1978. In 1979 alone, the value of new direct investment by foreign investors in the U.S. increased by more than \$15 billion, and in 1980, by approximately \$10 billion, to a level of nearly \$70 billion. Most of these investments were made by companies based in the United Kingdom, the Netherlands, Germany, and Canada, and about 20% of these investments in the U.S. were made by developing nations. In addition, based on the latest estimate of the Arab Federation of Chambers of Trade, Industry, and Agriculture, the total foreign investment by the Arab oil-producing countries has now reached approximately \$405 billion, and this figure is expected to rise to \$990 billion by 1985.

Furthermore, the total value of international trade for the U.S. in 1981 was approximately half a trillion dollars, exports totalling \$235

## 1. INTRODUCTION AND OVERVIEW

billion and imports about \$262 billion. For most European and newly industrialized countries, international trade accounts for a significant share (usually more than 25 %) of their economic activity. Finally, more than 50 % of the income of many international corporations over the last few years was generated from operations outside their native countries (for example, IBM, Nestlé, and CIBA-GEIGY). In short, the economies of virtually every country in the world have become increasingly interconnected by international business developments and activities.

Yet the impact of international developments affects far more than just the firms engaged in international business. As the OPEC oil embargo and price hikes of the 1970s clearly demonstrated, even purely domestic firms in most countries felt the impact of international developments through oil shortages, higher energy prices, and the resulting economic recessions. In addition, many domestic firms closed and workers were unemployed due to increased competition in domestic markets from imports.

As a result of these international business developments, the professional accounting, business, and financial communities had to pay greater attention to international business activities and the international problems of accounting. As international business competition increased, new challenges arose (both threats and opportunities). Firms' failures to understand and anticipate these challenges increasingly led to decreased international competitiveness and financial performance, and in some cases, bankruptcy. Many of the firms that attempted to expand internationally found the international aspects of business difficult. Managers often found that proven ways of doing business successfully in their domestic markets were not always successful in foreign countries. Competitive conditions were unfamiliar, different laws were involved, and business and cultural practices varied from country to country—including accounting standards and practices. In addition, many firms confronted, for the first time, dealing in foreign currencies and the ensuing problems of foreign exchange gains and losses. In the meantime, firms facing import competition lacked knowledge of what supported the foreign exporters' success; as a result, these domestic firms did not know how to compete with foreign firms or how to diminish their competitive impact.

In short, firms in virtually all countries were suddenly confronted with the need to increase their international awareness and skills, and yet only a small percentage of them had the existing capability to do so. Perhaps ironically, of all industrialized nations, the shortage of in-

ternational capability was most acute in the United States, where a large domestic market had for so long insulated U.S. firms from international activities. In addition, domestic investors and creditors found it increasingly difficult to understand the financial reports of firms with international activities. The investors and creditors, too, lacked an adequate understanding of the international aspects of business, and so the internationalized financial statements being prepared by firms often seemed confusing to them.

In response to the new need for international awareness and skills in the U.S. business and financial communities, new educational programs had to be developed. For example, the American Assembly of Collegiate Schools of Business (AACSB) changed its accreditation standards in 1974 to include a requirement that the international dimensions of business be added to the undergraduate and graduate curricula.

The American Accounting Association also recognized that future accountants should be knowledgeable about the international dimension of business, and particularly about the international aspects of accounting. It formally recognized this need in 1978, by calling for significant increases in the international content of the accounting curriculum. The reasons for this change are clear. Accounting reports prepared on the bases of different national accounting standards and kept in many different national languages and currencies need to be adjusted, translated and consolidated. These reports must be prepared to satisfy the needs of owners, various governments, and international agencies.

The flow of accounting reports across national borders generates the real need for an international dimension in accounting. Accounting is the language of business. For it to serve the needs of international investors, creditors, and managers, it must become an international language that seeks to harmonize accounting standards and reports.

But apart from the needs of international investors, creditors, and managers, there is another important reason for studying international accounting: to learn from the experiences of other countries. While accounting can serve many different purposes, it also serves similar purposes in many countries. Yet, at the same time, while the purposes may be the same in different countries, there are often differences in the approach taken. Accounting for inflation is a good example. Almost all countries attempt to account for inflation, but their approaches differ. Some methods of accounting for inflation are more successful than others. By studying how various countries account for inflation, and what successes they have, another country can more efficiently design or

## 1. INTRODUCTION AND OVERVIEW

adapt its own approach. The same general benefits can be gleaned from the study of many other foreign accounting practices. Finally, studying another country's accounting system also helps the individual to understand better his or her own country's accounting system.

The objectives of this chapter are to explain the variety of accounting practices and practitioners throughout the world, and to identify the need both for a better understanding of the international dimensions of accounting and for a greater similarity of accounting systems and professions among nations.

### ENVIRONMENTAL INFLUENCES ON ACCOUNTING

The most general purpose of accounting is to provide financial information to people for decision-making purposes. Therefore, one of the major reasons accounting is done differently in various countries is because the users and preparers of accounting information are themselves different. For example, people differ in their educational backgrounds, which determine the sophistication of information they can absorb and understand. In the extreme case, if they cannot read, they cannot make use of written financial reports. In less extreme cases, if they are unable to understand consolidation procedures, they will not make effective use of consolidated financial statements. Or, if they lack familiarity with the meaning of earnings per share, then they cannot make use of that kind of information. Therefore, the sophistication and complexity of accounting varies directly with the sophistication and education of the users of accounting information. It also varies directly with the sophistication and education of the people who prepare the statements: the accountants. If the accountants are not sophisticated enough to understand how to account for foreign exchange gains and losses, or even for inflation, then the accounting procedures for these phenomena will not be developed or utilized correctly. As this chapter and Chapter 7 describe, the educational backgrounds and expertise of accountants in foreign countries vary widely.

Users also differ in the information they want from financial reports. Creditors want one kind of information, investors want other kinds of information, governments have still other needs, while employees want information that may not be important to the other three. Because accounting seeks to provide the information desired by its users, account-



ing grows more complicated as there are more varieties of users and as the kinds of information they require become more varied. In societies where the government owns all enterprises, and where the desire of the government is to use accounting information primarily for national economic planning and decision-making purposes, a single, highly standardized and uniform system of accounting typically develops. In countries where most industrial enterprises are privately owned by a small number of very wealthy families, accounting reports are not likely to be numerous or publicly available. Where business operations rely heavily on bank credit, accounting is likely to be creditor-oriented rather than investor-oriented. These situations differ sharply from the conditions found in the United States, which has a large investing public, thousands of publicly held firms, a highly organized stock market with a strong regulatory agency, the Securities and Exchange Commission, and virtually no government ownership of, or government economic planning for, business enterprises. As a result, U.S. accounting reports tend to be more varied and investor-oriented. In short, the more users of information there are in a country, and the greater the differences among the needs of those users, the more complex a country's accounting procedures and reports are likely to be.

However, differences in accounting uses, users, and preparers form only one dimension of the many environmental factors that influence accounting. Sociocultural, legal and political, and economic conditions also have an impact upon a country's accounting standards and practices.

### **Sociocultural Conditions**

Among the major and more interesting sociocultural conditions that influence accounting are a people's attitude toward secrecy, time, fate, and business.

The attitude toward secrecy in a country largely influences the collection and dissemination of accounting information, and is generally related to the degree of trust people have in each other and in their institutions. Logically, in a country where people are generally secretive, they are not likely to provide much information to others, whether in accounting or in any other field. It is difficult in such a country to obtain accounting information from businesses, and what can be obtained is usually not very detailed. Therefore, external reports are seldom prepared and are not very well disclosed, and auditing is difficult.