

FREDERICK D.S. CHOI / GERHARD G. MUELLER

INTERNATIONAL ACCOUNTING



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Preface

International accounting has not remained immune from the so-called information explosion that has inundated civilized societies. Bits and pieces of information are often outdated before they are printed or stored. We have made an effort to update the 1978 predecessor book, in terms of both data and subject matter. More than 90 percent of the material in the present edition is new.

Six years ago we asserted that international accounting had come of age. Now the field is shifting from adolescence to young adulthood. Some of the early impetuosity has given way to serious scholarship. Highly emotional issues, like setting international standards of accounting and auditing or recognizing foreign exchange translation gains or losses in the operating results of the current period, are now recognized as important but nevertheless modest components of the much larger international accounting field. Such issues are receiving research attention and are subject to matter-of-fact ongoing business and governmental decision making. Early maturity has set in.

This book has accounting roots. It is written from an accounting perspective rather than a legal, socioeconomic, or multinational business perspective. The book was written, and the end-of-chapter discussion questions, exercises, and cases assembled, with students in mind. We made a deliberate effort to keep our writing style simple and to use illustrations and numeric examples to enhance learning efficiency. Upper-division undergraduate and masters students are our target audience along with practicing professional accountants and financial managers of multinational enterprises and international institutions. In

an undergraduate setting, this book will either stand on its own or benefit from supplementation through a readings collection. At the graduate level, research-based current literature will serve useful supplementation purposes. This type of literature is identified in the selected references cited at the end of each chapter.

Mainline international subject matter comprises the scope of this book. There are a number of issues and/or topical areas that might have been treated more comprehensively had additional space been available. Examples of such topics are international balance of payments accounting, accounting and control in centrally controlled economies like those of Eastern Europe, the special accounting problems of the developing nations, and internationally comparative accounting education and experience patterns. These speciality issues within the international accounting field are best pursued through current periodical literature or the occasional special-purpose book they have spawned.

Textbooks assimilate many different sources and wide ranges of ideas as well as practices. In this respect, our effort is no exception. A growing number of academics are specializing in international accounting and their writings have benefited our work. The same holds for the output from all of the institutions and organizations identified in Chapter 12. Many of our students have brought fresh ideas to classroom sessions and triggered new thought patterns in term papers submitted. To all of these, we express our collective thanks.

Several individuals warrant special credit. Professors Maureen H. Berry at University of Illinois at Urbana-Champaign, Frank D. Ewing at California State Polytechnic University-Pomona, and Mary J. Phelan at College of Holy Cross reviewed the predecessor book and made many useful suggestions that found their way into this new book. Professor R. S. Gupta of Chicago State University reviewed our manuscript and provided a full measure of helpful hints and suggestions. We have a better product as a consequence of the contributions received from these individuals and we wish to acknowledge their assistance with a personal note of thanks.

Many individuals furnished able assistance in producing the manuscript—especially Ms. Norma Cancellieri at New York University and Ms. Gracie Robledo at the University of Washington. The publisher's personnel encouraged us during the writing period, were patient with us when deadlines could not be met, and provided much help and good advice throughout the production period. Our sincere "Mahalo" to the entire production crew!

However hard one tries to avoid them, a number of errors are certain to occur in a project of this type. As authors we accept full responsibilities for any failures in judgment, communication, or physical production of the manuscript. We would much like to have the opportunity of receiving comments from all those who have occasion to use this book.

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1

International Dimensions of Accounting

The first name of this book is *International*. This term screams at us from newspaper headlines and the six o'clock news. It has become a common feature of lead articles in magazines and the mainstay of the travel industry. Politicians use it to support or castigate, as the case may be, almost any political issue of the day. To some it triggers fear, helplessness, or even despair. Others see in it much of the hope for tomorrow. The literature on international topics has become so enormously voluminous that any attempt to summarize it would be doomed from the start. Thus, we have picked four short quotes at random to set the scene for this book.

Economic Interdependence

Under the title of "The Changing World of Corporate Finance," Deloitte Haskins & Sells recently offered its views on some international dimensions of today's business:

Global competitiveness has been dubbed the "new game" or the "next economics." As nations attempt to speed their economic progress, enlightened corporate managements are increasingly viewing domestic and overseas markets as integral parts of a single market. Innovative companies are moving quickly to improve their ability to manage strategically on a global scale, as chief executives and chief financial officers adopt multinational strategies and financial policies that foresee changing competitive and regulatory environments.

With the emergence of an expanding interdependent global economy in place of distinct national economies, nations and individual firms no longer enjoy insular prosperity or self-sufficiency. Over the next 20 years, they will become even more closely linked within a global web of resources, markets, financing, production, capabilities, economics and politics. Governments will be participating directly and indirectly to help their own businesses and industries compete.

Developed and developing nations will become more interdependent. In the developed countries, the trend is already away from heavy manufacturing toward high technology and knowledge-intensive industries.

Developing nations are seeking to benefit by "adding value" to raw materials *before* they are exported. They are increasing the rate of technological transfer from industrial nations into their economies to capitalize on their resources and lower labor costs. Developing nations are aligning themselves with trading partners that will provide reciprocal access to markets. They reject industries being "discarded" by developed nations, and instead are encouraging their own growth industries.¹

How worthwhile is this new worldwide economic interdependence? Professor Paul W. McCracken, the noted economist now teaching at the University of Michigan, recently commented in the *Wall Street Journal* on the benefits of international trade. Here is an excerpt from his observations:

On the whole the liberal and open postwar trading and financial system has acquitted itself well. During the last three decades the proportion of world output finding a market across national boundaries rose steadily. Indeed, for much of this period the rate of increase in the volume of international trade was almost double that for world output. Economic well-being was doubly served. Real incomes rose more rapidly as nations could move away from costly self-sufficiency and toward areas in which they had a comparative advantage. And some discipline was imposed on inflationary tendencies, since markets where costs are getting out of line or product development is allowed to lag are markets that attract imports.

This liberal order worked well for the U.S. too. The proportion of our output of products (GNP less services) exported reached about 20% as the 1980s opened, compared with about 10% a decade earlier. And these U.S. products that found their markets in other countries are more than grains. The ratio of exports of manufacturing products to "Goods GNP" during the last decade also doubled. Thus the U.S. is much more influenced by and dependent upon the world economy than only a few years ago. The growth of this interdependence has outpaced our thinking about these matters.²

Since multinational companies (MNCs)—also referred to as multinational enterprises (MNEs) or transnational corporations (TNCs)—are a dominant group of standard-bearers in today's world of economic outreach, they are often praised and condemned in the same breath. A view from the Third World is provided by Y. G. Chouksey:

The MNCs, like the curate's egg, have proved to be good in parts. They have offered many gains to the developed countries. They could have done much more

¹ Reprinted with the special permission of *Dun's Business Month* (formerly *Dun's Review*), June, 1982, copyright 1982, Dun & Bradstreet Publications Corporation, p. 92.

² Reprinted with the author's permission from the *Wall Street Journal*, June 25, 1982.

for the third world. However, their errors of omission and commission in pursuing their economic goals are not so exasperating as to ask them to pack off lock, stock and barrel. Multinationals can play an effective role in overcoming the drudgery and economic stagnation of the poor countries. They can win the acceptance and confidence of the poor countries by practising more intently what they have been professing. Their R & D brilliance needs finding a wider expression and implementation. A more effective and more frequent give-and-take in this respect is very necessary.³

And what does it all mean to individual entities? There are stories of bank failures because foreign loans became uncollectable. Unemployed industrial workers are angry because their jobs were "exported" to other countries. In contrast, here is a news item about a local CPA practice office:

In many ways, Geller and Geller is what the public accounting profession calls a local practice office. Its 20 employees, including four partners, operate in unpretentious offices in midtown Manhattan, literally in the shadow of some of the largest CPA firms' national headquarters.

But there the resemblance to other small firms ends, for nearly 40 percent of Geller and Geller's work is done for international clients. The firm is 1 of 18 members of Jeffreys Henry International (JHI), a partnership of small and medium-sized firms in 13 countries with administrative offices in London. And while such international federations of smaller firms generally are considered new phenomena, JHI began, in an informal way, nearly two decades ago.⁴

Thus, we have a glimpse of international business during the 1980s. Convention has it that elaborate statistics on volumes of world trade and direct foreign investments should be presented to underscore the point. International balances of payments data could be used as further evidence, as could lists of percentages of international activities by the world's largest corporations.⁵ The ready availability of such data suggests that we forego the temptation to reiterate them once again here.

Accounting Specialization

Accounting is the surname of our title. As the field of accounting and the practicing accounting profession mature, they are experiencing many parallels to other professional fields like law and medicine. Of particular interest is the seemingly unavoidable need to specialize. Law and medicine already have well-entrenched specializations (i.e., civil, criminal, and international law, and "colleges" of gynecologists, surgeons, and urologists). Recognized specializations in accounting have developed in recent years and are coming fully into their own as the twentieth century draws to a close.

³ Y. G. Chouksey, "Multinational Corporations: An Evaluation," *Lok Udyog* (India), July 1978, p. 30.

⁴ "A Local Practitioner's Global Outlook," *Journal of Accountancy*, November 1980, p. 58. Report of an interview of Morton Geller by *Journal* news editor Tom Bisky.

⁵ James Cook, "A Game Any Number Can Play," *Forbes*, June 25, 1979, pp. 49-62.

The year 1975 is probably a good benchmark for the full recognition of subareas in accounting. Until then everything in accounting was asserted to be “general purposes”—from higher education programs in colleges and universities to professional examinations (i.e., the *Uniform Certified Public Accountants Examination*) and the preparation of published financial statements. “Generally accepted accounting principles” were deemed to have utility for all users of financial information (e.g., banks, government regulators and policy makers, business management, stockholders, and unions). Taxation and management consultancy services provided by professional CPA firms were deemed “in-house” specialties *not* requiring much special outside training or, least of all, separate certification.

Today, specialization in accounting is an accomplished fact. In the United States, separate professional examinations now recognize Certified Public Accountants, Certified Internal Auditors, Certified Management Accountants, and Chartered Financial Analysts. In Germany, the Public Auditor Certificate must be surrendered if the holder earns less than one-half of his or her professional income from public auditing services. In some Commonwealth countries, management consultancy practices are relegated to separate professional services companies established by (but operating separately from) firms of Chartered Accountants.

In the United Kingdom, annual accounts are often published separately from directors’ reports as well as reports to a company’s employees. In the United States, the American Institute of Certified Public Accountants (AICPA) now has membership divisions for firms serving clients with Securities and Exchange Commission (SEC) filing and reporting requirements and others with closely held clients. The Financial Accounting Standards Board (FASB) has exempted closely held companies from certain of its financial accounting requirements (e.g., segmental reporting). Multinational enterprises face a number of reporting requirements not applicable to domestic enterprises.

International (or multinational or transnational) accounting is one of several recognized specialties in the accounting field. It takes its place alongside governmental accounting, tax accounting, auditing, management accounting, behavioral accounting, and financial information systems.

INTERNATIONALIZATION OF ACCOUNTING

The internationalization of accounting is induced by four critical factors:

1. Multinational enterprise operations
2. Internationalization of money capital markets
3. International nature of some technical accounting problems
4. Historical antecedents

Multinational Enterprise (MNE) Operations

The organizational phenomenon of the multinational enterprise is here to stay. Depending on how one measures, there are probably 1,000 corporations in the world that can be classified as multinational and whose total annual sales volume each exceeds \$250 million. Again, depending on the measuring rod applied, the MNEs produce approximately one-fourth of the world's total economic output. To repeat an earlier point, some persons hold the MNEs in contempt for their asserted rise beyond most national laws, international economic exploitation, and power-play strategies. Others see them as highly efficient economic engines, transferers of knowledge and skills to multitudes of countries, and as significant economic and social development agents. Whatever one's view, the economic power of the MNEs as a group is substantial and unquestioned. Careful scholarly study, like that undertaken by Professor Raymond Vernon of Harvard University, supports the thought that the MNEs are here to stay. Their relative growth rates may have been largest during the 1950s and 1960s, but their collective strength is unlikely to diminish.

Parenthetically, we note that MNEs headquartered outside the United States have grown relatively faster than those domiciled in the United States. Table 1.1 portrays this trend.

Multinational enterprises are highly adaptable organizations. They constantly shift resources on a worldwide scale. These shifts cannot be accomplished in an effective and efficient manner unless highly reliable financial information permits careful analysis of investment opportunities and continuous control of the deployment of available resources.

Aside from analyzing economic opportunities and controlling multinational operations, the MNEs must somehow reconcile the plethora of existing

TABLE 1.1 The World's 500 Largest Industrial Corporations: Number of Companies by Sales

SALES (\$ MILLION)	1963		1971		1979	
	U.S.	NON-U.S.	U.S.	NON-U.S.	U.S.	NON-U.S.
Over \$10,000	2	0	3	1	20	27
\$5,000-\$9,999	1	1	9	3	38	43
\$3,000-\$4,999	5	1	14	14	53	53
\$1,000-\$2,999	41	13	101	66	108	158
\$ 800-\$ 999	16	16	29	19	—	—
\$ 600-\$ 799	25	20	51	48	—	—
\$ 400-\$ 599	51	43	73	69	—	—
\$ 200-\$ 399	127	87	—	—	—	—
Less than \$200	32	19	—	—	—	—
Total	300	200	280	220	219	281

Source: Conference Board (US), *The World's Multinationals: A Global Challenge*, 1981. Table adapted from "The 'Migration' of Multinational Corporations," *Chronicle* (Arthur Andersen & Co.), Vol. 40, No. 1, 1981, p. 8.