## Accounting in the International Business

1. Accounting information is the means by which firms communicate their financial position to the providers of capital investors, creditors and government. 

2. Just as different countries have different political systems, economic systems and cultures, historically they have also had different accounting systems. 

3. Accounting being totally scientific is not affected by the environment in which it operates. 

4. In the United States, government regulations require firms to publish detailed information about their training and employment policies. 

5. Since 2001, the U.S. requires that goodwill associated with acquisitions has to be amortized against earnings. 

6. When one company acquires another in a takeover, the value of the goodwill is calculated as the amount paid for a firm above its book value. 

7. In the United States, banks are the most important source of external capital for business enterprises. 

8. In the United States and Great Britain, the financial accounting system is oriented toward providing individual investors with the information they need to make decisions about purchasing or selling corporate stocks and bonds. 

9. In countries such as Switzerland, Germany and Japan, historically a few large banks satisfied most of the capital needs of business enterprises. 

10. Since banks are the major providers of capital in countries like Germany, financial accounting practices involve overvaluing assets and valuing liabilities conservatively. 

11. In countries like France and Sweden, financial accounting practices tend to be oriented toward the needs of banks and individual investors. 

12. Similarities in the accounting systems of countries are sometimes due to the countries' close political and/or economic ties. 

13. United States adopted the current cost accounting approach in 1980. 

14. Current cost accounting adjusts all items in a financial statement to factor out the effects of inflation. 

15. Developed nations tend to have small, complex organizations, whose accounting problems are far more difficult than those of large organizations. 

16. Using the cultural typologies developed by Hofstede, researchers have found that the extent to which a culture is characterized by uncertainty avoidance seems to have an impact on accounting systems. 

17. According to Hofstede, countries such as Britain, the United States and Sweden are characterized by high uncertainty avoidance. 

18. Auditing standards are rules for preparing financial statements and define what useful accounting information is. 

19. Transnational financing occurs when a firm based in one country enters another country's capital market to raise capital from the sale of stocks or bonds. 

20. Transnational investment occurs when an investor based in one country enters the capital market of another nation to invest in the stocks or bonds of a firm based in that country. 

21. An investor based in the Middle East buying Exxon Mobil Corporation stock through the New York Stock Exchange would be an example of transnational financing. 

22. The rapid expansion of transnational financing and investment in recent years has been accompanied by a corresponding decline in transnational financial reporting. 

23. Today, it is increasingly accepted that the standardization of accounting practices across national borders is in the best interests of all participants in the world economy. 

24. The IASB was formed in March 2001 to replace the International Accounting Standards Committee. 

25. The IASB has enough regulatory muscle to enforce its standards. 

26. The impact of the IASB standards has probably been least noticeable in the United States because of policy directives that direct U.S. public companies to adhere to domestic standards. 

27. The EU has required that from January 1, 2005 onward, financial accounts issued by some 7,000 publicly listed companies in the EU were to be in accordance with IASB standards. 

28. A consolidated financial statement combines the separate financial statements of two or more companies to yield a single set of financial statements as if the individual companies were really one. 

29. Most multinational firms are composed of a parent company and a number of subsidiary companies located in various other countries. 

30. The subsidiaries of a multinational company are separate legal entities as well as separate economic entities. 

31. The purpose of consolidated financial statements is to provide accounting information about a group of companies that recognize their economic interdependence. 

32. Transactions among the members of a corporate family are not included in consolidated financial statements. 

33. Without consolidated financial statements, a multinational firm could conceal losses in an unconsolidated subsidiary. 

34. Foreign subsidiaries of multinational firms normally keep their accounting records and prepare their financial statements in US dollars. 

35. Under a current rate method, the exchange rate at the balance sheet date is used to translate the financial statements of a foreign subsidiary into the home currency of the multinational firm. 

36. U.S.based multinational firms must follow the requirements of Statement 52, "Foreign Currency Translation," issued by the Financial Accounting Standards Board in 1981. 

37. Most international businesses require all budgets and performance data within the firm to be expressed in the "corporate currency," which is normally the home currency. 

38. According to Lessard and Lorange, the three exchange rates that can be used to translate foreign currencies into the corporate currency are the historical rate, the spot rate and the forward rate. 

39. Firms pursuing the global strategy and the transnational strategy disperse each value creation activity to its optimal location in the world. 

40. Managers of foreign subsidiaries should never be evaluated in local currency terms. 

**Multiple Choice Questions**

41. This has often been referred to as "the language of business."   
**A.** Accounting  
B. Business math  
C. English  
D. Financial transacting

42. Identify the incorrect statement pertaining to accounting information.   
A. It is often referred to as "the language of business."  
B. It is means by which firms report their income to the government  
**C.** It is consistent and standard across all countries  
D. It enables the providers of capital to assess the value of their investments

43. One of the key accounting problem faced by international businesses but that does not confront purely domestic businesses is   
**A.** The lack of consistency in the accounting standards of different countries  
B. The consistent, inaccurate filing of profit-and-loss statements by all international businesses  
C. The total lack of the accounting functions in international firms  
D. International firms not reporting their income to the government

44. Which of the following statement about accounting is not ?   
A. Accounting is shaped by the environment in which it operates  
**B.** Historically, different countries have had similar accounting systems  
C. In all countries, the accounting system has evolved in response to the demands for accounting information  
D. A good accounting function is critical to the smooth running of the firm and to a nation's financial system

45. Any advantage, such as a trademark or brand name that enables a firm to earn higher profits than its competitors is best known as a firm's   
A. Operating advantage  
B. Proprietary advantage  
C. Core competency  
**D.** Goodwill

46. Identify the incorrect statement regarding the differences in the treatment of goodwill across countries.   
A. When one company acquires another in a takeover, the value of the goodwill is calculated as the amount paid for a firm above its book value  
B. Accounting rules in many countries allow acquiring firms to deduct the value of goodwill from the amount of equity or net worth reported on their balance sheet  
**C.** Since 2001, the U.S. requires that goodwill associated with acquisitions has to be amortized against earnings  
D. In the United States, until recently goodwill has had to be deducted from the profits of the acquiring firm over as much as 40 years

47. Which of the following is not one of the main variables that influence the development of a country's accounting system?   
**A.** The relationship between individuals and social groups  
B. Political and economic ties with other countries  
C. The level of inflation  
D. The prevailing culture in a country

48. All of the following are the main external sources of capital for business enterprises except   
A. Individual investors  
B. Banks  
C. Government  
**D.** Retained earnings

49. Which of the following statement about the external sources of capital is not ?   
A. A country's accounting system tends to reflect the relative importance of individual investors, banks and government as providers of capital  
B. The three main external sources of capital for businesses are individual investors, banks and government  
**C.** In most advanced countries, only one of the main sources of external capital is important  
D. The importance of each source of capital varies from country to country

50. In the United States, \_\_\_\_\_ are the major source of external capital.   
**A.** Individual investors  
B. Banks  
C. Government  
D. Retained earnings

51. Which of the following observations is of the financial accounting system of countries such as Switzerland, Germany and Japan?   
A. Historically, individual investors satisfied most of the capital needs of businesses  
B. Banks play an insignificant role in satisfying the capital needs of businesses  
C. Government regulations do not mandate any public disclosure of a firm's financial position  
**D.** Assets are valued conservatively and liabilities are overvalued

52. Historically, financial reports prepared by firms in Germany,   
**A.** Tended to contain less information than those of British or U.S. firms  
B. Tended to contain all information required by individual investors  
C. Did not make any public disclosure of a firm's financial position  
D. Overvalued assets and undervalued liabilities

53. Identify the country where historically the national government has been a more important provider of capital, which has influenced accounting practices.   
A. United States  
**B.** France  
C. Germany  
D. Switzerland

54. Identify the country whose accounting practices have not been influenced by the U.S. accounting system.   
A. Canada  
B. Mexico  
C. Philippines  
**D.** Germany

55. This principle assumes the currency unit used to report financial results is not losing its value due to inflation.   
A. Current cost accounting  
B. Mark to market accounting  
**C.** Historic cost principle  
D. Financial accounting

56. The historic cost principle   
**A.** Assumes the currency unit used to report financial results is not losing its value due to inflation  
B. Records sales, purchases and the like at an adjusted transaction price and makes minor adjustments in the amounts later  
C. Does not affect accounting in the area of asset valuation  
D. Overestimates a firm's assets if inflation is high

57. This accounting method adjusts all items in a financial statement—assets, liabilities, costs and revenues—to factor out the effects of inflation.   
**A.** Current cost accounting  
B. Operating profit method  
C. Historic cost principle  
D. Economic accounting

58. Accounting in developed countries tends to be far more sophisticated than it is in less developed countries because of all of the following reasons except   
A. They tend to have large, complex organizations, whose accounting problems are far more difficult than those of small organizations  
B. They have sophisticated capital markets in which business organizations raise funds from investors and banks  
**C.** Their accounting system was basically inherited from former colonial powers  
D. Their workforces tend to be highly educated and skilled and can perform complex accounting functions

59. \_\_\_\_\_ refers to the extent to which cultures socialize their members to accept ambiguous situations.   
A. Noblesse oblige  
**B.** Uncertainty avoidance  
C. Social interaction  
D. Cultural Dilemma

60. According to Hofstede, this country is characterized by low uncertainty avoidance.   
A. Greece  
**B.** Sweden  
C. Japan  
D. Mexico

61. These are rules for preparing financial statements and they define what is useful accounting information.   
A. Financial standards  
B. Auditing standards  
**C.** Accounting standards  
D. Operating standards

62. The technical process by which an independent person gathers evidence for determining if financial accounts conform to required accounting standards and if they are also reliable is known as   
A. An accounting guideline  
B. An operating procedure  
C. Standardization  
**D.** An audit

63. Until recently, which of the following accounting practices has been ?   
A. Japanese law generally allowed revaluation  
B. Dutch standards prohibited revaluation and prescribes historic cost  
C. Capitalization of financial leases was required practice in France  
**D.** German accountants have treated depreciation as a liability

64. Transnational \_\_\_\_\_ occurs when a firm based in one country enters another country's capital market to raise capital from the sale of stocks or bonds.   
**A.** Financing  
B. Development  
C. Sale  
D. Investment

65. Which of the following occurs when an investor based in one country enters the capital market of another nation to invest in the stocks or bonds of a firm based in that country?   
A. Transnational financing  
B. Transnational development  
C. Transnational sale  
**D.** Transnational investment

66. A German firm raising capital by selling stock through the London Stock Exchange is an example of   
**A.** Transnational financing  
B. Transnational development  
C. Transnational sale  
D. Transnational investment

67. An investor based in Japan buying General Motors stock through the NYSE would be an example of   
A. Transnational financing  
B. Transnational development  
C. Transnational sale  
**D.** Transnational investment

68. The International Accounting Standards Board   
A. Has enough power to enforce its standards  
**B.** Was formed to replace the International Accounting Standards Committee  
C. Has 120 members responsible for the formulation of new financial reporting standards  
D. Requires approval from 80 percent of its 120 members to issue a new standard

69. All of the following are hindrances to the development of international accounting standards except   
**A.** Its impact has been least noticeable in the United States  
B. The IASB has no power to enforce its standards  
C. Its compliance is voluntary  
D. To issue a new standard, 75 percent of the 14 members of the board must agree

70. To date, the impact of the IASB standards has probably been least noticeable in the United States. Why?   
A. Because compliance is voluntary  
**B.** Because most IASB standards have been consistent with opinions already articulated by the U.S. FASB  
C. Because of the significant differences between the IASB standards and generally accepted accounting principles  
D. Because most U.S. companies already use IASB standards to report their results

71. A \_\_\_\_\_ combines the separate financial statements of two or more companies to yield a single set of financial statements as if the individual companies were really one.   
A. Complied financial statement  
B. Harmonized financial statement  
**C.** Consolidated financial statement  
D. Operating financial statement

72. Many firms find it advantageous to organize as a set of separate legal entities or subsidiaries because of all of the following reasons except   
A. It limits their total legal liability  
B. To take advantage of corporate tax regulations  
C. Of legal requirements in the countries in which they do business  
**D.** Subsidiaries are all separate economic entities

73. Consolidated financial statements   
**A.** Provide accounting information about a group of companies that recognize their economic interdependence  
B. Record transactions among the members of a corporate family  
C. Show assets, liabilities, revenues and expenses of members of a corporate family  
D. Issue individual financial statements for the parent company and each subsidiary

74. Foreign subsidiaries of multinational firms normally   
**A.** Keep their accounting records in the currency of the country in which they are located  
B. Do not prepare their financial statements  
C. Prepare their financial statements in US dollars  
D. Keep their accounting records in US dollars

75. Under the \_\_\_\_\_, the exchange rate at the balance sheet date is used to translate the financial statements of a foreign subsidiary into the home currency of the multinational firm.   
A. Temporal method  
**B.** Current rate method  
C. Operating cost accounting method  
D. Historic cost principle

76. This method translates assets valued in a foreign currency into the home-country currency using the exchange rate that exists when the assets are purchased.   
**A.** Temporal method  
B. Current rate method  
C. Operating cost accounting method  
D. Historic cost principle

77. All of the following statements are according to Statement 52, except   
A. The local currency of a self-sustaining foreign subsidiary is to be its functional currency  
B. The balance sheet for self-sustaining foreign subsidiaries is translated into the home currency using the exchange rate in effect at the end of the firm's financial year  
C. The income statement of self-sustaining foreign subsidiaries is translated using the average exchange rate for the firm's financial year  
**D.** The functional currency of an integral subsidiary is to be the currency of the country in which it is located

78. Which of the following is typically not a main step in the control process by which a corporate headquarters controls subunits within the organization?   
A. Head office and subunit management jointly determine subunit goals for the coming year  
**B.** Head office monitors subunit performance against the agreed goals only at the end of the year  
C. If a subunit fails to achieve its goals, the head office intervenes in the subunit to learn why the shortfall occurred  
D. If a subunit fails to achieve its goals, the head office can take appropriate corrective action if required

79. Most international businesses require all budgets and performance data within the firm to be expressed in the "corporate currency," which is normally   
A. US dollars  
B. The host currency  
**C.** The home currency  
D. The eurocurrency

80. Which of the following is not one of the three exchange rates pointed out by Lessard and Lorange that can be used to translate foreign currencies into the corporate currency in setting budgets and in the subsequent tracking of performance?   
A. The initial rate  
B. The projected rate  
C. The ending rate  
**D.** The consolidated rate

**Essay Questions**

81. Describe accounting in the international business. What is accounting information?

Accounting has often been referred to as "the language of business." This language finds expression in profit-and-loss statements, balance sheets, budgets, investment analysis and tax analysis. Accounting information is the means by which firms communicate their financial position to the providers of capital investors, creditors and government. It enables the providers of capital to assess the value of their investments or the security of their loans and to make decisions about future resource allocations. Accounting information is also the means by which firms report their income to the government so the government can assess how much tax the firm owes. It is also the means by which the firm can evaluate its performance, control its internal expenditures and plan for future expenditures and income.

82. Identify a key accounting problem that international businesses are confronted with but that does not confront purely domestic businesses. Substantiate with a suitable example.

International businesses are confronted with a number of accounting problems that do not confront purely domestic businesses. One of these problems is the lack of consistency in the accounting standards of different countries. For example, the accounting rules currently used in China are not the same as those used in more developed markets. This makes it very difficult for international investors to accurately value Chinese firms and it opens up the possibility that firms that seem to be profitable and financially strong are in fact not.

83. What are the five main variables that influence the development of a country's accounting system?

The five main variables that influence the development of a country's accounting system are: 1. The relationship between business and the providers of capital. 2. Political and economic ties with other countries. 3. The level of inflation. 4. The level of a country's economic development. 5. The prevailing culture in a country.

84. What is the relationship between business and providers of capital and the development of a country's accounting system?

The three main external sources of capital for business enterprises are individual investors, banks and government. A country's accounting system tends to reflect the relative importance of these three constituencies as providers of capital. In the United States, for example, business firms can raise capital by selling shares and bonds to individual investors through the stock market and the bond market. They can also borrow capital from banks and, in rather limited cases, from the government. The importance of each source of capital varies from country to country. In some countries, such as the  
United States, individual investors are the major source of capital; in others, banks play a greater role; in still others, the government is the major provider of capital.

85. How is a country's accounting system affected by the providers of capital? Explain with the help of suitable examples.

In both Great Britain and the United States, the financial accounting system is oriented toward providing individual investors with the information they need to make decisions about purchasing or selling corporate stocks and bonds.  
In countries such as Switzerland, Germany and Japan, historically a few large banks satisfied most of the capital needs of business enterprises. Because banks are the major providers of capital, financial accounting practices are oriented toward protecting a bank's investment. Thus, assets are valued conservatively and liabilities are overvalued to provide a cushion for the bank in the event of default.  
In still other countries, the national government has historically been an important provider of capital, which has influenced accounting practices. For example in France and Sweden the national government has often stepped in to make loans or to invest in firms whose activities are deemed in the "national interest." In these countries, financial accounting practices tend to be oriented toward the needs of government planners.

86. How do political and economic ties with other countries influence the development of a country's accounting system?

Similarities in the accounting systems of countries are sometimes due to the countries' close political and/or economic ties. For example, the U.S. system has influenced accounting practices in Canada and Mexico and since passage of NAFTA, the accounting systems in these three countries seem set to converge on a common set of norms. U.S.-style accounting systems are also used in the Philippines, which was once a U.S. protectorate.  
The vast majority of former colonies of the British Empire have accounting practices modeled after Great Britain's. Similarly, the European Union has been attempting to harmonize accounting practices in its member countries.

87. What is the historic cost principle?

The historic cost principle assumes the currency unit used to report financial results is not losing its value due to inflation. Firms record sales, purchases and the like at the original transaction price and make no adjustments in the amounts later. The historic cost principle affects accounting most significantly in the area of asset valuation. If inflation is high, the historic cost principle underestimates a firm's assets, so the depreciation charges based on these underestimates can be inadequate for replacing assets when they wear out or become obsolete.  
The appropriateness of this principle varies inversely with the level of inflation in a country.

88. Describe the current cost accounting system.

The high level of price inflation in many industrialized countries during the 1970s and 1980s created a need for accounting methods that adjust for inflation.  
Great Britain adopted one of the most far-reaching approaches in 1980, called current cost accounting. This system adjusts all items in a financial statement—assets, liabilities, costs and revenues—to factor out the effects of inflation. The method uses a general price index to convert historic figures into current values.

89. Identify the reasons why accounting in developed countries tends to be far more sophisticated than it is in less developed countries.

Developed nations tend to have large, complex organizations, whose accounting problems are far more difficult than those of small organizations. Developed nations also tend to have sophisticated capital markets in which business organizations raise funds from investors and banks. These providers of capital require that the organizations they invest in and lend to provide comprehensive reports of their financial activities. The workforces of developed nations tend to be highly educated and skilled and can perform complex accounting functions.

90. How does the culture of a country influence the nature of its accounting system? What is uncertainty avoidance?

Researchers have found that the extent to which a culture is characterized by uncertainty avoidance seems to have an impact on accounting systems. Uncertainty avoidance refers to the extent to which cultures socialize their members to accept ambiguous situations and tolerate uncertainty. Research suggests that countries with low uncertainty avoidance cultures tend to have strong independent auditing professions that audit a firm's accounts to make sure they comply with generally accepted accounting regulations.

91. What are auditing standards? How are they different from accounting standards?

Auditing standards specify the rules for performing an audit—the technical process by which an independent person (the auditor) gathers evidence for determining if financial accounts conform to required accounting standards and if they are also reliable. Accounting standards are rules for preparing financial statements; they define what is useful accounting information.

92. With the help of examples, differentiate between transnational financing and transnational investments.

Transnational financing occurs when a firm based in one country enters another country's capital market to raise capital from the sale of stocks or bonds. A German firm raising capital by selling stock through the London Stock Exchange is an example of transnational financing.  
Transnational investment occurs when an investor based in one country enters the capital market of another nation to invest in the stocks or bonds of a firm based in that country. An investor based in Great Britain buying General Motors stock through the New York Stock Exchange would be an example of transnational investment.

93. Write a short note on the International Accounting Standards Board?

The International Accounting Standards Board has emerged as a major proponent of standardization. The IASB was formed in March 2001 to replace the International Accounting Standards Committee, which had been established in 1973. The IASB has 14 members who are responsible for the formulation of new international financial reporting standards. By 2006 the IASB and its predecessor, the IASC, had issued around 45 international accounting standards. To issue a new standard, 75 percent of the 14 members of the board must agree.  
A hindrance to the development of international accounting standards is that compliance is voluntary; the IASB has no power to enforce its standards. Even so, support for the IASB and recognition of its standards has been growing. Increasingly, the IASB is regarded as an effective voice for defining acceptable worldwide accounting principles.

94. Highlight he role of the European Union in harmonization of accounting standards in the EU.

In accordance with its plans for closer economic and political union, the EU has mandated harmonization of the accounting principles of its member countries. The EU does this by issuing directives that the member states are obligated to incorporate into their own national laws. Because EU directives have the power of law, it has a better chance of achieving harmonization than the IASB does. The EU has required that from January 1, 2005 onward, financial accounts issued by some 7,000 publicly listed companies in the EU were to be in accordance with IASB standards.

95. What is a consolidated financial statement? What type of firms usually makes use of it?

A consolidated financial statement combines the separate financial statements of two or more companies to yield a single set of financial statements as if the individual companies were really one. Most multinational firms are composed of a parent company and a number of subsidiary companies located in various other countries. Such firms typically issue consolidated financial statements, which merge the accounts of all the companies, rather than issuing individual financial statements for the parent company and each subsidiary.

96. Why is it advantageous for firms to organize themselves as a set of separate legal entities? How do consolidated financial statements benefit these firms?

Many firms organize themselves as a set of separate legal entities to limit its total legal liability or to take advantage of corporate tax regulations. Multinationals are often required by the countries in which they do business to set up a separate company. Thus, the typical multinational comprises a parent company and a number of subsidiary companies located in different countries, most of which are wholly owned by the parent. However, although the subsidiaries may be separate legal entities, they are not separate economic entities. The purpose of consolidated financial statements is to provide accounting information about a group of companies that recognize their economic interdependence.

97. Describe the current rate method used by firms to determine what exchange rate should be used when translating financial statement currencies.

Under the current rate method, the exchange rate at the balance sheet date is used to translate the financial statements of a foreign subsidiary into the home currency of the multinational firm. Although this may seem logical, it is incompatible with the historic cost principle.

98. What is the temporal method used to translate the accounts of a foreign subsidiary? Explain with the help of an example.

The temporal method translates assets valued in a foreign currency into the home-country currency using the exchange rate that exists when the assets are purchased.  
For example, a U.S. firm invests $100,000 in a Malaysian subsidiary. The exchange rate was of $1 = 5 ringgit, the rate on the day the Malaysian subsidiary purchased the land, would be used to convert the value of the land back into U.S. dollars at year-end. However, although the temporal method will ensure that the dollar value of the land does not fluctuate due to exchange rate changes, it has its own serious problem. Because the various assets of a foreign subsidiary will in all probability be acquired at different times and because exchange rates seldom remain stable for long, different exchange rates will probably have to be used to translate those foreign assets into the multinational's home currency. Consequently, the multinational's balance sheet may not balance.

99. Describe the Statement 52, whose requirements all U.S.based multinational firms must follow.

The Statement 52, "Foreign Currency Translation," was issued by the U.S. Financial Accounting Standards Board in 1981. Under Statement 52, a foreign subsidiary is classified either as a self-sustaining, autonomous subsidiary or as integral to the activities of the parent company.  
According to Statement 52, the local currency of a self-sustaining foreign subsidiary is to be its functional currency. The balance sheet for such subsidiaries is translated into the home currency using the exchange rate in effect at the end of the firm's financial year, whereas the income statement is translated using the average exchange rate for the firm's financial year. But the functional currency of an integral subsidiary is to be U.S. dollars. The financial statements of such subsidiaries are translated at various historic rates using the temporal method and the dangling debit or credit increases or decreases consolidated earnings for the period.

100. Describe the Lessard–Lorange Model.

According to research by Donald Lessard and Peter Lorange, three exchange rates that can be used to translate foreign currencies into the corporate currency in setting budgets and in the subsequent tracking of performance. These were the initial rate, the projected rate and the ending rate.  
According to the Lessard–Lorange model, the best way to deal with this problem is to use a projected spot exchange rate to translate both budget figures and performance figures into the corporate currency.