Chapter 13
Issues in International Accounting

# TRUE/FALSE

1. The FASB was the first standard-setting body to address translation of foreign-based operations and holdings into U.S. dollars.
**ANS: F**
2. The *U.S. dollar orientation* approach to the translation of foreign operations requires an enterprise to account for foreign operations as if those operations actually occurred in U.S. dollars.
**ANS: T**
3. The *U.S. dollar orientation* approach to the translation of foreign operations assumes that foreign currency denominated assets, liabilities, revenues, and expenses are measured in the foreign currency but are translated to U.S. dollars for reporting purposes.
**ANS: F**
4. SFAS No. 8 required the temporal method of translation.
**ANS: T**
5. Under the temporal method of translation, all balance sheet items that are carried at current or future exchange prices are translated at the current exchange rate, while items carried at past prices are translated at exchange rates existing at the time the item was acquired.
**ANS: T**
6. Accounting exposure is the exposure to exchange gains and losses resulting from translating U.S.-dollar-denominated financial statements into foreign denominations.
**ANS: F**
7. Economic exposure directly affects consolidated cash flows.
**ANS: T**
8. SFAS No. 52 adopted a currency U.S. dollar orientation to accounting for foreign currency operations.
**ANS: F**
9. An objective of translation under SFAS No. 52 is to avoid reporting foreign-currency-denominated operations as if they had occurred in U.S. dollars.
**ANS: T**
10. Under SFAS No. 52, if the results of foreign-currency-denominated operations will not affect U.S. dollar cash flows, no exchange gain or loss is recorded.
**ANS: T**
11. The key question addressed by SFAS No. 52 involves how to report exchange gains and losses on the income statement.
**ANS: F**
12. Financing indicators are included in the guidelines provided by SFAS No. 52 for determining the functional currency.
**ANS: T**
13. The functional currency is defined as the currency of the country in which the foreign subsidiary is located.
**ANS: F**
14. The United States is included in the independent discipline dimension of accounting development.
**ANS: T**
15. Harmonization of accounting standards refers to the degree of coordination or similarity among the various sets of national accounting standards and methods and the formats of financial reporting.
**ANS: T**
16. Many continental model countries, such as France and Germany, have viewed harmonization as an opportunity to coordinate their accounting standards with those of the United States.
**ANS: F**
17. The International Accounting Standards Committee was formed in an attempt at economic integration of member countries.
**ANS: F**
18. The United States is not a member of G4 +1.
**ANS: F**
19. British standard-setters blazed the trail of accounting regulation being centered in the private sector.
**ANS: F**
20. Countries following the continental model include most major countries of Western Europe as well as Japan
**ANS: T**
21. The key factor of difference between the Anglo-American and continental models appears to be between capital-based financial markets and credit-based financial markets.
**ANS: T**
22. Financial reporting is independent of the legal system of a nation.
**ANS: F**
23. The IASC has not yet promulgated a conceptual framework.
**ANS: F**
24. The European Union has extended consolidation accounting to firms within its member states under a very wide group of circumstances where one firm has substantive control over one or more other firms.
**ANS: T**
25. Because of important national differences, a strong drive for harmonization of accounting standards has not yet been possible.
**ANS: F**

# MULTIPLE CHOICE

1. Which of the following standard-setting bodies was the first to address translation of foreign-based operations and holdings into U.S. dollars?
a. CAP **XXXXX**
b. APB
c. FASB
d. SEC
2. Which of the following does not apply to the Bretton Woods Agreement of 1944?
a. The developments surrounding the agreement have heightened the importance of how translation of foreign-based operations should be handled.
b. It established controlled exchange rates worldwide. **XXXXX**
c. It allowed monetary authorities to buy or sell gold or foreign exchange with the intent of maintaining an allowable exchange rate fluctuation.
d. It collapsed in 1971 resulting in freer and more volatile exchange rate fluctuations.
3. Which of the following applies to the *U.S. dollar orientation* approach to the translation of foreign operations?
a. It requires an enterprise to account for foreign operations as if those operations actually occurred in U.S. dollars. **XXXXX**
b. It recognizes that the foreign operations occurred in a foreign currency and that those operations may not affect U.S. dollars.
c. Foreign currency denominated assets, liabilities, revenues, and expenses are assumed to be measured in the foreign currency but are translated to U.S. dollars for reporting purposes.
d. The effects of changing exchange rates are not reported in income until the net assets are exchanged.
4. Which of the following is **not** a true statement regarding SFAS No. 8?
a. SFAS was faithful to the historical cost accounting model, but from an economic viewpoint it produced illogical results.
b. SFAS No. 8 required the temporal method of translation.
c. In empirical studies made of the economic impact of SFAS No. 8 on American multinational enterprises, only foreign exchange risk and management policies regarding hedging of foreign currency exposures were found to have any possible impact.
d. SFAS No. 8 was consistent with the foreign currency orientation. **XXXXX**
5. Accounting exposure is:
a. The exposure to exchange gains and losses resulting from translating U.S.- dollar-denominated financial statements into foreign denominations.
b. The exposure to exchange gains and losses resulting from translating foreign-currency-denominated financial statements into U.S. dollars. **XXXXX**
c. The exposure to cash flow changes resulting from dealings in foreign- denominated transactions and commitments.
d. A result of the need to use more U.S. dollars to settle a foreign-currency- denominated debt.
6. Economic exposure is:
a. The exposure to exchange gains and losses resulting from translating U.S.- dollar-denominated financial statement into foreign denominations.
b. The exposure to exchange gains and losses resulting from translating foreign-currency-denominated financial statements into U.S. dollars.
c. The exposure to cash flow changes resulting from dealings in foreign- denominated transactions and commitments. **XXXXX**
d. A result of the need to use more foreign currency to settle U.S. dollar denominated debt.
7. With the temporal method of translation:
a. All balance sheet items that are carried at current or future exchange prices are translated at the current exchange rate. **XXXXX**
b. Balance sheet items carried at past prices, such as fixed assets are translated at the current exchange rate.
c. Income statement items are translated at the current exchange rate.
d. Income statement items are translated at historical exchange rates.
8. Which of the following directly affects consolidated cash flows?
a. Accounting exposure
b. Economic exposure **XXXXX**
c. Both accounting exposure and economic exposure
d. Neither accounting exposure nor economic exposure
9. SFAS No. 52 adopted:
a. A U.S. dollar orientation to accounting for foreign currency operations.
b. A functional currency orientation to accounting for foreign currency operations. **XXXXX**
c. A foreign currency orientation to accounting for foreign currency operations.
d. None of the above
10. What is the objective of translation under SFAS No. 52?
a. To avoid reporting accounting exchange gains and losses when an economic gain or loss has not occurred.
b. To avoid reporting foreign-currency-denominated operations as if they had occurred in U.S. dollars.
c. To maintain a U.S. dollar orientation.
d. Both a and b **XXXXX**
11. Which of the following is a true statement regarding SFAS No. 52?
a. When a foreign entity’s currency is the functional currency, net income is measured in the foreign currency and then restated into dollars at the current exchange rate at the end of the period.
b. When a foreign entity’s currency is the functional currency, any exchange adjustment resulting from translating balance sheet and income statement items at different exchange rates is recognized as a gain or loss on the income statement.
c. When a foreign entity’s currency is the functional currency, all balance sheet items are translated at the average exchange rate for the period.
d. If the results of foreign-currency-denominated operations will not affect U.S. dollar cash flows, no exchange gain or loss is recorded. **XXXXX**
12. Which of the following is **not** a true statement regarding SFAS No. 52?
a. The key question brought up in SFAS No. 52 involves how to report exchange gains and losses on the income statement. **XXXXX**
b. The six guidelines or economic factors provided by SFAS No. 52 for determining the functional currency have a differential cash flow orientation.
c. The six indicators provided by SFAS No. 52 have been found to provide adequate guidance for determining the functional currency.
d. The six indicators provided by SFAS No. 52 for determining the functional currency have a foreign currency component and a parent’s currency component.
13. Which of the following if **not** one of the six guidelines or economic factors provided by SFAS No. 52 for determining the functional currency?
a. Sales price indicators
b. Interest rate indicators **XXXXX**
c. Expense indicators
d. Intercompany transactions and arrangements
14. Which of the following is **not** true if the functional currency of a foreign operation is U.S. dollars?
a. All balance sheet items that were carried at current or future exchange prices are translated at the current exchange rate.
b. All balance sheet items carried at past prices are translated at exchange rates existing at the time the item was acquired.
c. All income statement items are translated at the average exchange rate for the reporting period. **XXXXX**
d. Exchange gains and losses arising from translation from the currency of record into the functional currency are recognized on the income statement.
15. What is meant by the term “functional currency”?
a. The functional currency is the currency of the parent corporation.
b. The functional currency is the currency of the country in which the foreign subsidiary is located.
c. The functional currency is the currency of the parent’s primary economic environment where cash is primarily received and spent.
d. The functional currency is the currency of the subsidiary’s primary economic environment where cash is primarily received and spent. **XXXXX**
16. Which of the following is a financial reporting model that features the presence of a strong accounting profession?
a. The Anglo-American model **XXXXX**
b. The continental model
c. The oriental model
d. The international model
17. The United States is an example of
a. The Anglo-American model **XXXXX**
b. The continental model
c. The oriental model
d. The international model
18. Which of the following is not one of Mueller’s four economic/political/professional dimensions to accounting development?
a. The macroeconomic pattern
b. The microeconomic pattern
c. The independent discipline approach
d. The diversified accounting approach **XXXXX**
19. The United States is best described as belonging to which dimension of accounting development?
a. The macroeconomic pattern
b. The microeconomic pattern
c. The independent discipline approach **XXXXX**
d. The diversified accounting approach
20. Anglo-American versus continental differences have been summarized using all but which of the following characteristics?
a. Strength of the accounting profession
b. Population size **XXXXX**
c. Strong equity markets as opposed to credit financing from major banking institutions
d. The importance of the country’s legal system relative to the setting of accounting rules
21. Which of the following is **not** one of Hofstede’s cultural dimensions of national accounting differences?
a. Developed versus developing **XXXXX**
b. Large versus small power distance
c. Masculinity versus femininity
d. Individualism versus collectivism
22. Which of the following is **not** a true statement regarding harmonization of accounting standards?
a. Harmonization refers to the degree of coordination of similarity among the various sets of national accounting standards and methods and the formats of financial reporting.
b. Among the factors underlying the desire for harmonization is the rise in importance of the multinational firm.
c. The issue of harmonization is closely tied to the efforts of the IASC as well as activities of the EU.
d. Many continental model countries, such as France and Germany, have viewed harmonization as an opportunity to coordinate their accounting standards with those of the United States. **XXXXX**
23. Which of the following is **not** a true statement regarding the IASC?
a. The IASC has recently promulgated a conceptual framework.
b. The IASC is playing an important role in the drive toward harmonization.
c. Several European nations have surrendered their standard-setting powers to the IASC. **XXXXX**
d. Members of the IASC have pledged to use their best endeavors to bring the adoption of IASC standards to their countries.
24. Which of the following organizations was formed in an attempt at economic integration, and has also been concerned with harmonization of accounting standard of its member nations?
a. The International Accounting Standards Committee
b. The International Federation of Accountants
c. The European Union **XXXXX**
d. The International Organization of Security Commissions
25. Which of the following is not a member of the G4+1.
a. IASC
b. Australia
c. United States
d. France **XXXXX**

# ESSAY QUESTIONS

1. a. What does the term *functional currency* mean?
b. What is the accounting treatment if the foreign entity’s currency is the functional currency?
c. What is the accounting treatment if the U.S. currency is the functional currency?

**ANSWER:**
a. The functional currency is the currency of the subsidiary’s primary economic environment where cash is primarily received and spent.
b. If the foreign entity’s currency is the functional currency, net income is measured in the foreign currency and then restated into dollars at the average exchange rate for the period. Any exchange adjustment resulting from translating balance sheet and income statement items at different exchange rates is displayed as a separate component of stockholders’ equity, not as a gain or loss on the income statement.
c. If the functional currency of a foreign operation is judged to be U.S. dollars the accounting records must be converted into U.S. dollars. This is called remeasurement and is done by following the temporal approach of SFAS No. 8. With this approach, all balance sheet items that were carried at current or future exchange prices are translated at the current exchange rate, while items carried at past prices are translated at exchange rates existing at the time the item was acquired. Income statement items are translated at the average exchange rate for the reporting period – except that items related to balance sheet accounts that were translated at historical exchange rates, such as cost of goods sold and depreciation, are also translated at the historical rates. Exchange gains and losses arising from translation from the currency of record into the functional currency would be recognized on the income statement.
2. a. What are the six guidelines that SFAS No. 52 provides for determining the functional currency?
b. What were the findings of the FASB research report by Evan and Doupnik regarding these six criteria?

**ANSWER:**
a. The six guidelines that SFAS No. 52 provides for determining the functional currency are as follows:
 1. Cash flow indicators
 a. Foreign Currency – Cash flows related to the foreign entity’s individual assets and liabilities are primarily in the foreign currency and do not directly impact the parent company’s cash flows.
 b. Parent’s Currency – Cash flows related to the foreign entity’s individual assets and liabilities directly impact the parent’s cash flows on a current basis and are readily available for remittance to the parent company.
 2. Sales price indicators
 a. Foreign Currency – Sales prices for the foreign entity’s products are not primarily responsive on a short-term basis to changes in exchange rates but are determined more by local competition or local government regulation.
 b. Parent’s Currency – Sales prices for the foreign entity’s products are primarily responsive on a short-term basis to changes in exchange rates; for example, sales prices are determined more by worldwide competition or by international prices.
 3. Sales market indicators
 a. Foreign Currency – There is an active local sales market for the foreign entity’s products, although there also might be significant amounts of exports.
 b. Parent’s Currency – The sales market is mostly in the parent’s country or sales contracts are denominated in the parent’s currency.
 4. Expense indicators
 a. Foreign Currency – Labor, materials, and other costs for the foreign entity’s products or services are primarily local costs, even though there also might be imports from other countries.
 b. Parent’s Currency – Labor, materials, and other costs for the foreign entity’s products or services, on a continuing basis, are primarily costs for components obtained from the country in which the parent company is located.
 5. Financing indicators
 a. Foreign Currency – Financing is primarily denominated in foreign currency, and funds generated by the foreign entity’s operations are sufficient to service existing and normally expected debt obligations.
 b. Parent’s Currency – Financing is primarily from the parent or other dollar-denominated obligations, or funds generated by the foreign entity’s operations are not sufficient to service existing and normally expected debt obligations without the infusion of additional funds from the parent company. Infusion of additional funds from the parent company for expansion is not a factor, provided funds generated by the foreign entity’s expanded operations are expected to be sufficient to service that additional financing.
 6. Intercompany transactions and arrangements indicators
 a. Foreign Currency – There is a low volume of intercompany transactions and there is not an extensive interrelationship between the operations of the foreign entity and the parent company. However, the foreign entity’s operations may rely on the parent’s or affiliates’ competitive advantages, such as patents and trademarks.
 b. Parent Currency – There is a high volume of intercompany transactions and there is an extensive interrelationship between the operations of the foreign entity and the parent company. Additionally, the parent’s currency generally would be the functional currency if the foreign entity is a device or shell corporation for holding investments, obligations, intangible assets, etc., that could readily be carried on the parent’s or an affiliate’s books.

b. The FASB research report by Evans and Doupnik found that the six criteria provided adequate guidance for determining the functional currency. Furthermore, the respondents to the study agreed very strongly that the standard works well. Of the six indicators, the four that were most heavily weighted were the first four listed above. Only a small percentage of the participants had difficulty in determining the functional currency in many cases.
3. Compare and contrast the Anglo-American financial reporting model with the continental model.

**ANSWER:** The *Anglo-American* financial reporting model features the presence of a strong accounting profession, a somewhat limited role of government, the importance of securities markets for raising equity capital, and an emphasis upon the *true and fair* view of audited financial statements. The true and fair view refers to the use of judgment in order to make financial statements useful instruments for making investment decisions, as opposed to ensuring that they have been presented correctly in accordance with legislative fiat. The *continental* model generally presents a relatively weak accounting profession; reflects strong governmental influence upon accounting regulation and organization, including the primacy of tax influences and the protection of creditors in financial statement presentation rather than for investor needs; and emphasizes the importance of debt financing through major banks rather than the raising of equity capital. The continental model emphasizes legalistic form over economic substance.
4. Identify and describe Mueller’s four dimensions to accounting development in market-oriented economies.

**ANSWER:** Mueller’s four dimensions to accounting development in market-oriented economies are as follows:
1. The **macroeconomic pattern**, where private sector accounting is closely linked to national economic policy.
2. The **microeconomic pattern**, where accounting is seen as an aspect of managerial economics with decision-making overtones. Capital maintenance is seen as an overriding aspect of financial reporting.
3. The **independent discipline approach**, where accounting is a service- type function deriving from business practice. Accounting should be able to develop based on the needs of business and users of financial statements. This approach requires the presence of a strong accounting profession. The “true and fair” and “present fairly” outlooks are examples of this approach. The U.S. in included in this category.
4. The **uniform accounting approach**, which may be divided into several different conceptions, such as the technical approach and the economic approach. The technical approach would be a finite and rigid uniformity approach, which tries to minimize agency theory problems and present information to users that will be highly comparable from firm to firm. The economic approach sees accounting as a control and administrative tool for national economic policies. It is similar to the macroeconomic pattern, but would be much stronger in its subservience to national economic policies, such as in Nazi Germany.
5. a. Identify and describe Hofstede’s cultural dimensions of national accounting differentiation.
b. What criticisms have been leveled against Hofstede’s cultural orientation?
c. What did Zarzeski find about the accounting practices of firms located in these various cultural environments?

**ANSWER:**
a. Hofstede’s cultural dimensions are as follows:
 1. Individualism versus collectivism – Collectivism indicates a tightly knot social grouping, whereas individualism implies a looser and freer social framework and resulting mode of action by members of the society.
 2. Large versus small power distance – In large power-distance societies, the place of individuals within the society is accepted by the participants; whereas much more unrest and turmoil relative to the power vested in institutions and organizations is present in small power-distance cultures.
 3. Strong versus weak uncertainty avoidance – In weak uncertainty- avoidance cultures, people feel relatively secure; whereas in strong uncertainty-avoidance societies, people have a stronger desire to manage the future and hedge or avoid risks than in weak uncertainty-avoidance cultures.
 4. Masculinity versus femininity – In masculine societies, qualities such as heroism, assertiveness, and financial and other forms of success are strongly desired, whereas in feminine-oriented cultures, altruism and similar forms of behavior prevail.
b. One criticism that has been leveled against Hogstede’s cultural orientation is that it is based upon survey research done with employees of only one company, IMB. Also, it is not clear how fruitful the masculine versus feminine dichotomy is because these terms cannot be easily applied to national states.
c. Zarzeski has found that firms located in countries that are more individualistic and masculine and have less uncertainty avoidance are more likely to have greater informative disclosure than firms with opposite characteristics. Furthermore, when firms have a higher international profile, they tend to be less secretive than firms from their home culture that have a lower international profile. On the other hand, continental countries that are more dependent upon debt financing, such as France and Germany, generally have less disclosure than in Anglo-American countries.
6. How did Gray extend Hofstede’s cultural dimensions to the values of the accounting subculture?

**ANSWER:** Zarseski has found that firms located in countries that are more individualistic and masculine and have less uncertainty avoidance are more likely to have greater informative disclosure than firms with opposite characteristics. Furthermore, when firms have a higher international profile, they tend to be less secretive than firms from their home culture that have a lower international profile. On the other hand, continental countries that are more dependent upon debt financing, such as France and Germany, generally have less disclosure than in Anglo-American countries.
7. What does harmonization of accounting standards mean, and what are the two aspects of harmonization?

**ANSWER:** Harmonization refers to the degree of coordination or similarity among the various sets of national accounting standards and methods, and formats of financial reporting. Harmonization has been broken down into two aspects: (1) material harmonization, which refers to harmonization among accounting measurements and disclosures of different countries or groups and (2) formal harmonization, which refers to the process or degree of harmonization present among the accounting rules or regulations of different countries or groups.
8. Identify the following organizations and describe the role each plays in the drive toward harmonization:
(1) The IASC
(2) The EU

**ANSWER:**
(1) The IASC (International Accounting Standards Committee) was formed in 1973 by professional accounting organizations from nine nations including the United States. It now has over one hundred member organizations from seventy nations. The AICPA is the American organization holding membership in the IASC. No nation or any professional body from any nation has surrendered its accounting standard-setting sovereignty to the IASC. Rather, the members have pledged to use their “best endeavors” to bring the adoption of IASC standards to their countries. As of fall 1999; thirty-nine international accounting standards had been issued by the IASC. Many less-developed nations with a limited professional accounting infrastructure use all or at least a majority of IASC standards.

 The pace of harmonization appears to have picked up since 1992. One reason for this is that the IASC is working for harmonization with the G4+1 (Australia, Canada, United Kingdom, United States, and IASC). The IASC has also worked to eliminate previously acceptable alternatives in its standards and has recently promulgated a conceptual framework.
(2) The EU (European Union) was formed in 1967 with 12 member countries. In addition to its attempts to integrate European countries economically and politically, the EU has been concerned with harmonization of accounting standards of its member nations. The Council of Ministers of the EU nations has issued several directives with important implications for accounting. Directives become binding upon the member countries, although they may not be implemented in exactly the same way by each nation.

 Two directives, the Fourth Directive and the Seventh Directive, contain important accounting matters. The Fourth Directive was adopted in 1978. The Fourth Directive concerns basic issues of financial reporting that are applicable to companies within the EU community. In addition to providing standard formats for financial statements, the directive states that financial statements be based on four concepts: consistency, going concern, prudence, and accrual accounting. The Fourth Directive permits current value statements in addition to historical costs and also calls for the application of the true and fair view. Since the true and fair view calls for going beyond accounting rules in order to portray economic reality, it is very questionable how it can be implemented given differences in definition, interpretation, and application among the countries constituting the EU. Furthermore, it is contended that the true and fair view is being interpreted in EU nations in terms of their own particular cultures and traditions. Increasingly, the true and fair view is seen as going from the need to “override” accepted accounting principles with full disclosures in order to show the facts and conditions of the enterprise truthfully to a diligent application of existing GAAP.

 The Seventh Directive was passed in 1983. It extends consolidation accounting to firms within the member states of the EU under a very wide group of circumstances where one firm has substantive control over one or more other firms. This directive, like the Fourth Directive, requires the true and fair view. Legislatures of member nations had all passed the Seventh Directive by 1992. While the national laws are not exactly the same, it is clear that the Seventh Directive has increased harmonization in the area of consolidation among the member nations. However, there are options allowed under the Fourth and Seventh Directives that allow for differences in some areas such as the definition of a subsidiary and consolidation exemptions where the ultimate parent is not an EU firm.