The need to be “financially bilingual” US GAAP vs IFRS

XVII. OTHER TOPICS

This presentation contains information, in addition to the material prepared and provided by the professor, from:

1. Elizabeth A. Gordon, Temple University, Jana S. Raedy, University of North Carolina, Alexander J. Sannella, Rutgers Business School, ©2016, Pearson | ISBN13: 9780132162302
2. Donald E. Kieso, Jerry J. Weygandt, Terry D. Warfield, Intermediate Accounting, 16th Edition
3. March 2016, ©2016
4. Doupnik T. and Perera H. INTERNATIONAL ACCOUNTING- CONT4029 (Custom Edition by Prof. Aida Lozada and Prof. Carmen Ríos. McGraw-Hill, 2014. ISBN 9781308235059.
5. Thimothy, D., Finn M., Gotti, G. and Perera, H. 5ed. INTERNATIONAL ACCOUNTING. Mc Graw Hill 2020, New York.
6. J. David Spiceland, James Sepe, Mark Nelson, Intermeiate Accounting, 6th edition, McGraw-Hill, 2014. ISBN-13: 978-0077614065 ISBN-10: 0077614062
7. Other: Official Websites

Foreign Currencies and Exchange Rates

Foreign Currencies and Exchange Rates IAS 21:

An exchange rate is the amount it costs to purchase one unit of currency with another currency.

https://cuex.com/en?gclid=EAIaIQobChMI9b6Mno3k6gIVkgiICR3TAweGEAAYASAAEgKQY_D_BwE

If a French citizen wants to buy $1 he must pay €.86

USD/EUR — Traveler Cheatsheet cuex.com — Exchange rates from 23/07/2020

To Buy — You Pay

USD		EUR	USD		EUR	USD		EUR
1	»	0.86	15	»	12.94	45	»	38.81
2	»	1.72	20	»	17.25	50	»	43.12
3	»	2.59	25	»	21.56	100	»	86.24
4	»	3.45	30	»	25.87	250	»	215.59
5	»	4.31	35	»	30.18	500	»	431.18
10	»	8.62	40	»	34.49	1,000	»	862.36

$1,000 x €.86 = $860

If an Italian friend comes to visit you in PR, and wants to spend $1,000, tell him to bring only $860

If an American citizen wants to buy 1€ he must pay $1.16

EUR/USD — Traveler Cheatsheet cuex.com — Exchange rates from 23/07/2020

To Buy — You Pay

EUR		USD	EUR		USD	EUR		USD
1	»	1.16	15	»	17.39	45	»	52.18
2	»	2.32	20	»	23.19	50	»	57.98
3	»	3.48	25	»	28.99	100	»	115.96
4	»	4.64	30	»	34.79	250	»	289.90
5	»	5.80	35	»	40.59	500	»	579.81
10	»	11.60	40	»	46.38	1,000	»	1,159.61

1.000€ x $1.16 = $1,160

If you wants to go to Spain and wants to spend €1.000 be prepare and have on hand $1,160

The need to be "financially bilingual" US GAAP vs IFRS

PRACTICE: The Exchange Rates

On January 1 of Year 1 ABC Company a U.S. reporter purchases an Inventory from a Germany Company for €100,000. The amount is payable in full on February 20, Year 1.

Rates:

- The spot rate is the price quoted for immediate settlement on a commodity/product, a security or a currency.
- Exchange rate is the rate at which one currency will be exchanged for another. It is also regarded as the value of one country's currency in relation to another currency.

The exchange rates are the following:

January 1: €1 = $.87 (To buy €1 = you need to pay $.87)
January 31: €1 = $.86 (To buy €1 = you need to pay $.86)
February 20: €1 = $.88 (To buy €1 = you need to pay $.88)

The need to be "financially bilingual" US GAAP vs IFRS

The exchange rates are the following:

January 1: €1 = $.87 (To buy €1 = you need to pay $.87)
January 31: €1 = $.86 (To buy €1 = you need to pay $.86)
February 28: €1 = $.88 (To buy €1 = you need to pay $.88)

JOURNAL ENTRIES

	January 1			
	Dr. Inventory (€100,000 x $.87)		$87,000	
	Cr. Account Payable			$87,000
	January 31			
	Dr. Account Payable	($.87-$.86) x €100,000	$1,000	
You will pay less	Cr. Gain on Rate Fluctuation	(OCI)		$1,000
	February 20			
	Dr. Account Payable		$86,000	
You will pay more	Dr. Loss on Rate Fluctuation	(OCI)	$2,000	
	Cr. Cash (€100,000 x $.88)			$88,000

<u>January 1</u>

Dr. Inventory	(€100,000 x $.87)	$87,000	
Cr. Account Payable			$87,000

<u>January 31</u>

Dr. Account Payable	($.87-$.86) x €100,000	$1,000	
Cr. Gain on Rate Fluctuation (OCI)			$1,000

<u>February 20</u>

Dr. Account Payable	($.87-$.86) x €100,000	$86,000	
Dr. Loss on Rate Fluctuation (OCI)		$2,000	
Cr. Cash (€100,000 x $.88)			$88,000

ACCOUNT PAYABLE

	January 1 $87,000
January 31 $1,000	
	$ 86,000
February 20 $86,000	
0	

GAIN (OCI)

	January 31 $1,000
February 20 $1000	
0	

*Eliminates the Gain and in addition recognize Loss for $1,000

PRACTICE: The Exchange Rates

On January 1 of Year 1 ABC Company a U.S. reporter sells Equipment to a Spanish Company for €100,000. The amount is collected in full on February 20, Year 2.

The exchange rates are the following:

January 1: €1 = $.87 (To buy €1 = you need to pay $.87)
January 31: €1 = $.86 (To buy €1 = you need to pay $.86)
February 20: €1 = $.88 (To buy €1 = you need to pay $.88)

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<u>The exchange rates are the following:</u>

January 1: €1 = $.87 (To buy €1 = you need to pay $.87)
January 31: €1 = $.86 (To buy €1 = you need to pay $.86)
February 28: €1 = $.88 (To buy €1 = you need to pay $.88)

JOURNAL ENTRIES

	<u>January 1</u>			
	Dr. Account Receivable (€100,000 x $.87)	$87,000		
	Cr. Sales Revenue			$87,000
	<u>January 31</u>			
You will receive less	Dr. Loss on Rate Fluctuation ($.87-$.86) x €100,000	$1,000 (OCI)		
	Cr. Account Receivable			$1,000
	<u>February 20</u>			
	Dr. Cash (€100,000 x $.88)		$88,000	
You will receive more	Cr. Gain on Rate Fluctuation			$2,000 (OCI)
	Cr. Account Receivable			$86,000

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JOURNAL ENTRIES

January 1

Dr. Account Receivable	(€100,000 x $.87)	$87,000	
Cr. Sales Revenue			$87,000

January 31

Dr. Loss on Rate Fluctuation	($.87-$.86) x €100,000	$1,000 (OCI)	
Cr. Account Receivable			$1,000

February 20

Dr. Cash (€100,000 x $.88)		$88,000	
Cr. Gain on Rate Fluctuation			$2,000 (OCI)
Cr. Account Receivable			$86,000

ACCOUNT RECEIVABLE

January 1 $87,000	
	January 31 $1,000
$ 86,000	
	February 20 $86,000
0	

GAIN (OCI)

	February 20 $2,000
0	

*Eliminates the Loss and in addition recognize a Gain for $1,000

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HEDGING

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HEDGING

- Refers to the strategy off *“cover the right side and the left side of the game field”*

- It is about “offset” both sides. So the gains and losses are offset one another.

Example: You bet a lot of money on a team in the Basketball World Cup, later you want to eliminate the risk of loss, then you bet on another team. Therefore you hedged your starting position by making a bet on another team. It is taking a 50% and 50% risk. Because you can lose one bet and lose another. The loss will be offset by a corresponding gain.

HEDGING

ACCOUNT RECEIVABLE AMOUNT IN € = ACCOUNT PAYABLE AMOUNT IN €

=

HEDGE POSITION

- A decrease in the foreign exchange rate will cause LOSSES on the foreign Account Receivable.
- A decrease in the foreign exchange rate will cause GAINS on the foreign Account Payable.

- An increase in the foreign exchange rate will cause GAINS on the foreign Account Receivable.
- An increase in the foreign exchange rate will cause LOSSES on the foreign Account Payable.

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HEDGING: FURTURE CONTRACTS

Many MNE do not have similar amounts of Account Receivable and Payable in a foreign country. The MNE can create this situation by buying or selling foreign currency using “*future contracts*”.

Future Contracts

OBLIGATION to exchange foreign currency at a future date

.

Is like have an Accounts Receivables in foreign currency.

Example: A MNE that has only foreign Accounts Payable may hedge its position by purhasisn a similar dollar amount of foreign currency by purchasing: *“Future Contracts”*.

If the foreign exchange rate rises, any losses on the foreign payables will be offset by a gain in the value of the *Future Contracts.*

HEDGING: OPTION CONTRACTS

Foreign currency option

RIGHT to sell foreign currency at a predetermined exchange rate and time

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HEDGING: FURTURE CONTRACTS

Many MNE do not have similar amounts of Account Receivable and Payable in a foreign country. The MNE can create this situation by buying or selling foreign currency using "*future contracts*".

Future Contracts

Are the right to receive a specified quantity of foreign currency at a future date.

Is like have an Accounts Receivables in foreign currency.

Example: A MNE that has only foreign Accounts Payable may hedge its position by purhasisn a similar dollar amount of foreign currency by purchasing: *"Future Contracts"*.

If the foreign exchange rate rises, any losses on the foreign payables will be offset by a gain in the value of the *Future Contracts.*

- Gain or loss is recognized currently in earnings.
- Available-for-sale securities, any gain or loss is reported in other comprehensive income.

EXCHANGE RISK FOR MNE

THE FOLLOWING FACTORS MUST BE EVALUATED

Customs duties

Tax treaties

Import fees

Tax laws

FOREIGN CURRENCY TRANSACTIONS

TRANSLATION
OF FOREIGN CURRENCY
FINANCIAL STATEMENTS

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TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS

ABC CO
INCOME STATEMENT
FOR THE YEAR ENDED YEAR 3
(Soles)

ABC CO
INCOME STATEMENT
FOR THE YEAR ENDED YEAR 3
(US Dollars)

		RATE	
Sales Revenues	20,000	(x $.110)	$2,200
Expenses	(12,000)	(x $.110)	($1,320)
Net Income	8,000		$880

	SOLES (PERU	U.S.
January 1, Year 1	1	$.125
December 31, Year 1	1	$.100
Average year 1	1	$.110

If dividends are paid, the translation is based on the historical rate when the dividend is paid.

TRANSLATION OF FOREIGN CURRENCY FINANCIAL STATEMENTS

ABC CO
BALANCE SHEET
FOR THE YEAR ENDED YEAR 1
(US DOLLARS)
(Translated at 12/31 Rate)

ASSETS			
Property, Plant and Equipment		$5,000	
Account Receivable		3,000	
Cash and Equivalents		2,000	
			$10,000
LIABILITIES			
Account Payable		$500	
Notes Payable		300	**$800**
EQUITY			
Ordinary shares		$1,000	
Preference shares		2,000	
Share premium,		5,000	
Revaluations Surplus		1,000	
Retained Earnings		1,500	
Accumulated Other Comprehensive Income			
Foreign Currency Translation Loss	**(1,300)**		**$9,200**
			$10,000

	SOLES (PERU	U.S.
January 1, Year 1	1	$.125
December 31, Year 1	1	$.100
Average year 1	1	$.110

INTERNATIONAL TAXATION

CONSIDER TAX WHEN:

1. Where to locate foreign operation
2. What legal form should foreign operation take
3. How the foreign operation will be financed

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TYPES OF TAXES

1. Imposed by governments (15% - 35%)
   - Zero percent in tax havens
   - National and Local taxing authorities

2. Withholding taxes
   - Taxes on dividends
   - Other paid to foreign citizens

3. Value-added Tax
   - Price of product
   - Price of service
   - At each stage of
     Production
     Distribution

Used: European Union, Australia, Canada, China, Mexico, Nigeria, Turkey, and South Africa

TAX: HEAVEN AND HOLYDAY

Tax Holiday

- Low to zero taxes for period of time
- Encourage foreign direct investment
- Usually have requirement regarding amount of investment and/or number of jobs created

Tax Haven

- Abnormally low corporate income tax rates or no corporate income tax
- Bahamas and the Isle of Man

No corporate income tax

75% of Fortune 500 have at least 1 subsidiary in tax haven (Doupnick, 5th ed

TAX JURSIDICTION

Nationality approach

Tax on all income of
Resident
Company of a country
Regardless of place of earning

Territorial approach

Tax only on
Income earned in that country

Participation exemption

Income of foreign branch of domestic firm taxed
Income of foreign subsidiary of domestic firm not taxed

BASIS FOR TAXATION

Source

- Followed by most of countries

Citizenship

Taxes citizens regardless of

Source

Residence

Residence

Taxes residents regardless of

Source

Citizenship

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COMPANY USA TAX RETURN

Assume : ABC, a USA Company has a multiple branch in Italy, and earns income of $500,000 and paid foreign income tax of $50,000 (10%). Also paid sales and other taxes of $20,000.

ABC Company USA Tax Return

	Deduction	Credit
Foreign Source Income	**$500,000**	**$500,000**
Deduction for Foreign tax paid	70,000	0
USA taxable income	$430,000	$500,000
US income tax liability	$75,000	$90,000
Foreign tax credit	(0)	(50,000)
USA tax liability	$75,000	$40,000

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DOUBLE TAXATION

- **Same income taxed**
  1. In a foreign country and
  2. Country of residence

- **Tax treaties provide relief from double taxation**
  1. Legally minimize taxes in foreign countries and home country
  2. Maximize after-tax cash flows

- **Tax credits provide relief from double taxation**
  1. Foreign tax credits

INTERNATIONAL TRANSFER PRICING

- Companies shift profits from countries with high-tax rates to countries with low-tax rates.
- Countries regulate international transfer pricing to ensure companies pay their fair share of local taxes.

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INTERNATIONAL AUDITING

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INTERNATIONAL AUDITING

- Internal auditing is an important component of management's control process
  1. Companies policies/procedures being followed
  2. Uncover errors, inefficiencies, and possibly fraud
  3. Abide by FCPA (Foreign Corrupt Practices Act)

- Issues faced by internal and external auditors
  1. Differences in language and culture
  2. Differences in accounting standards and auditing standards

- PCAOB
  1. Enhance relevance and usefulness of audit report
  2. PCAOB has authority to
  3. Establish auditing standards
  4. Establish quality control standards
  5. Establish ethic rules for conduct of audit
  6. Inspect audit firms

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INTERNATIONAL STANDARDS ON AUDITING

- The International Federation of Accountants (IFAC) develops international auditing standards.
- Through International Auditing and Assurance Standards Board (IAASB).

In United States

- Auditing Standards Board (ASB) division of AICPA promulgates audit standards for non-public companies.
- PCAOB promulgates audit standards for public companies.

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INTERNATIONAL AUDITING

REQUIREMENT TO BE AUDITOR

1. US - uniform system of examination (CPA) (sign an Independent Auditor Report)
2. UK - 4 professional bodies conduct own exam
3. Germany - exam administered Ministry of Economics
4. China - CPA firms must be approved by state to audit foreign-owned, joint ventures or Chinese company on exchange.

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INTERNATIONAL AUDITING: FACTORS

- Cultural values impact nature and quality of audit work undertaken
- Perception of ethical conduct influenced by cultural norms
- Perception of independence based on environmental differences
- Differences in environment impacting auditing
- Accounting and securities market regulation
- Economic and political systems
- Patterns of business ownership
- Complexity of business firms
- Stages of economic development

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INTERNATIONAL AUDITING: AUDIT REPORTS

1. The content of audit reports varies significantly between countries, and sometimes between companies in the same country.

- For example, audit reports sometimes refer to local audit standards, non-local audit standards, multiple sets of audit standards, or are addressed to different audiences.

- The Sarbanes-Oxley Act in the U.S. includes a requirement to provide assurance on the internal controls

COPORATE GOVERNANCE

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CORPORATE GOVERNANCE

Form in which an organization is administrate or managed.

Good corporate governance helps to build an environment of trust, transparency and accountability necessary for fostering long-term investment, financial stability and business integrity, thereby supporting stronger growth and more inclusive societies.

The Organization for Economic Co-operation and Development (OECD) is an international organization that works to build better policies for **better lives**. Our goal is to shape policies that foster prosperity, equality, opportunity and well-being for all.

http://www.oecd.org/

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CORPORATE GOVERNANCE: PRINCIPLES

The Principles are intended to help policymakers evaluate and improve the legal, regulatory, and institutional framework for corporate governance, with a view to support economic efficiency, sustainable growth and financial stability. This is primarily achieved by providing shareholders, board members and executives as well as financial intermediaries and service providers with the right incentives to perform their roles within a framework of checks and balances.

http://www.oecd.org/

CORPORATE GOVERNANCE: PRINCIPLES

I. Ensuring the basis for an effective corporate governance framework

The corporate governance framework should promote transparent and fair markets, and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.

II. The rights and equitable treatment of shareholders and key ownership functions

The corporate governance framework should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.

III. Institutional investors, stock markets, and other intermediaries

The corporate governance framework should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance.

IV. The role of stakeholders in corporate governance

The corporate governance framework should recognize the rights of stakeholders established by law or through mutual agreements and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

V. Disclosure and transparency

The corporate governance framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.

VI. The responsibilities of the board

The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders.

http://www.oecd.org/

COPORATE SOCIAL RESPONSIBILITY

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COPORATE SOCIAL RESPONSIBILITY

There a are two theories that are used to explain the purpose of the sustainability reporting.

Stakeholder Theory:

“sustainability reporting is in response to the stakeholder demand for that type of information”

Legitimacy Theory:

“sustainability reporting is a strategy to manage the public exposition, political and social pressures”

This has made the disclosure that the Companies make voluntary

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SUSTAINABILITY VALUE REPORT AND CORPORATE RESPONSIBILITY REPORT

Information about an entity's environmental and social policies and practices

Mostly voluntary but required in several countries

Provide information on:

1. Environmental impact
2. Labor practices
3. Product safety
4. Innovation
5. Others

Dimensions

1. Environment
2. Social Capital
3. Human Capital
4. Business Model and Innovation
5. Leadership and Governance

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GRI

GRI helps businesses and governments worldwide understand and communicate their impact on critical sustainability issues such as climate change, human rights, governance and social well-being. This enables real action to create social, environmental and economic benefits for everyone. The GRI Sustainability Reporting Standards are developed with true multi-stakeholder contributions and rooted in the public interest.

STANDARDS

The GRI Standards are the first global standards for sustainability reporting. They feature a modular, interrelated structure, and represent the global best practice for reporting on a range of economic, environmental and social impacts.

https://www.globalreporting.org

GLOBAL REPORTING INITIATIVE GRI

ACCEPTED SUSTAINABILITY STANDARDS

GRI standards in 4 categories: disclosures both quantitative and qualitative

Universal
- Basic reporting issues of reliability, timeliness, comparability

Economic
- Corruption and anti-competitive behavior

Environment
- Energy and water consumption
- Biodiversity and emission of pollutants

Social
- Labor practices
- Human rights
- Product responsibility

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GLOBAL REPORTING INITIATIVE GRI

SEC Sustainability Reporting Requirement

1. Climate change disclosures threats and opportunities in 10k.
2. Business description; cost of complying with environmental laws including capital expenditures.
3. Legal proceedings; litigation related to emissions and violations of environmental rules.
4. Risk factors; risks related to climate change and climate-related legislation.
5. MDA; effects of climate change and climate change regulation into required disclosures.

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COMPARATIVE ACCOUNTING

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Two techniques to implementing IFRS

ADOPTION

Adoption means abandoning the country’s current financial reporting standards and replacing them with IFRS.

- Europe Union 2005
- Canada 2011

CONVERGENCE

Convergence means changing the countries existing standards so that they will produce IFRS “equivalent” financial reports.

- Australia 2007
- Brazil 2010

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ACCOUNTING DIVERSITY: IFRS VARIATION IN THE APPLICATION

	ASSETS REVALUATION	LIFO	GOODWIL IMPAIRMENT	DEPRECIATION BASE	DISCLOSURE: SEGMENT
United States	No	Yes	Impairment	Economic	Yes
United Kingdom	Yes	No	Impairment	Economic	Yes
Japan	No	Yes	Amortize (20 Yrs)	Tax	Yes
Germany	No	No	Amortize (4yrs)	Tax	Limited
China	No	Yes	Impairment	Economic/Tax	No
Brazil	No	Yes	Impairment	Economic	No
Russia	No	Yes	Amortize (20 Yrs)	Tax	No

Source: Financial Accounting IFRS (Asia Global Edition), Williams, Haka, Bettner, Carcello, Lam, Lau