Discussion: international financial reporting

Discussion: climate change

IFRS VS Non- IFRS GAAP

Foreign currency transactions

International accounting and corporate governance; accounting issues in global financial crisis; foreign currency; international financial reporting quality; environmental influence including culture on accounting; international auditing; international financial reporting standards and global convergence; carbon accounting and climate change week 4, 6, 7, 9, 12

2,5,7,10,15,1,12

Week 9 international accounting standards and global convergence

International Financial Reporting Standards (**IFRS**) are designed as a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.

Setting Department

It is issued by IASC and new IASB took over the responsibility for setting International Accounting Standards.

Key impacts of IFRS (Notes) –Why IAS provided a higher quality financial reporting?

- **First**, we argue that IFRS restrict or reduce alternative accounting choices. Thus even though managers have incentives to manage earnings, they have less options/opportunities to do so.
- **Second,** IFRS reduce the ambiguity and inconsistence of local standards, so it is easier to interpret and implement. This will reduce the likelihood that managers take advantage of ambiguous standards to manage earnings.
- **Third,** IFRS also would improve financial reporting quality by changing manager incentives. It is generally accepted that managerial incentives are influenced/determined by economic and political systems.

Moreover, the accounting standards itself form part of the overall economic and political systems. Thus, changes in accounting and reporting standards also create incentives for manager to produce high quality financial reporting.

Rules-based or principles-based standards

- Rules-based
  - Detailed and complex standards
  - Resulted in transaction manipulation
  - Enlarged gap between managers and owners
- Principles-based (IAS)
  - Reflects "true" underlying economic substance
  - Provides increased protection for companies

- Makes comparability across companies difficult
- Scandals and aftermath perhaps=>need principle-based standards
- Sarbanes-Oxley requires the SEC to examine the feasibility of principles-based standards
- Problems with principles-based standards
  1. Guidance for application
  2. Comparability
  3. No guidance for complex transactions

Survey by Mike Ng (2004): neither approach will ensure that coys report the economic reality of transactions

IFRS and U.S. GAAP

Major differences are in the areas of:

- Property, plant and equipment revaluations
- Deferred taxes
- Goodwill
- Capitalized borrowing costs

Impact of accounting differences on profit and net assets (UK firm & HKBC);
Impact on decision-making

- international standards to solve
  1. IASB and FASB are working toward similar accounting standards
  2. FASB is researching international convergence, identity, catalog, resolve, recommend further agenda decision diff btw GAAP, IFRS
  3. Objective: achieve compatibility by identifying common, high-quality decision.
  4. Benefits of convergence according to the FASB
     1) Increasing **efficiency** of the <u>global capital market</u>
     2) Reduce <u>administrative burden</u> of MNE
     3) Enabling US companies to access capital markets outside the USA <u>without reconcile US GAAP</u>

Benefits of IFRS:

- increase comparability
- reduce misunderstanding
- reduce time and money for restatement of financial report
- Help international investors and globalization of capital market.

Disadvantages of IFRS:

- Accounting differences are due to underlying economic and financial and tax system
- IASB does not have authority to enforce standards
- Progress: EU, Australia, China, US
- Future: harmonize IFRS and US GAAP
- Impact of IFRS on practices

Debate on impact if IFRS

- Jeanjean and Stolowy J.: Harmonizing management incentives and institutional factors rather than harmonizing accounting standards.
- Ball R: underlying economic and political factors influencing managers and auditors incentives and determine reporting quality, not the accounting standards.
-

1. Pressures for the harmonization of international accounting as a means of achieving comparability 可比性 are growing, but the term harmonization is often used rather loosely and interchangeable with standardization.

The major participant groups interested in disclosure:

(1) Governments (2) Trade unions and employees (3) investors (including financial analysts) (4) bankers and lenders (5) accountants and auditors

1. 1.) GOVERNMENTS
    - Government involvement in accounting determination varies across the world
    - Use reports, along with segmental information to check performance of local subsidiaries of MNEs
    - Governments wish to monitor MNE operations as a whole

    2.) Intergovernmental org
    - United nations, aim is international disclosure standards; emphasis on developing counties
    - OECD, represents industrialized nations, issued Guidelines for Multinational Enterprises (为了 加强 confidence btw MNEs and governments, not required by law) => promote improvements in comparability and harmonization of standards.
    - European Union, involved in international harmonization of standards as part of company law harmonization, => promote European economic integration and development, protect stakeholder's interests. Harmonization of stock exchange regulations and securities laws 特权
2. Trade unions and employees
    - Information needs depend on K and purpose of information
3. Investors
    - Interested in segmental information of MNEs and consolidated results;
    - Some want regulatory approach rather than a mkt approach to disclosure
    - Investors, including financial analysis, are those who have access to corporate reports and use them and other publicly available information as a basis for making investment decisions.
4. Bankers and lenders
    - Focused on financial position, performance and future prospects
    - Concerned with security of loans advanced
    - Have more direct access to required inform
5. Accountants and auditors
    - IASB objectives:
      (a) Formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their worldwide acceptance and observance

(b) To work generally for the improvement and harmonization of regulations, accounting standards, and procedures relating to the presentation of financial statements.

International federation of Accountants (IFAC)

- Sets international auditing guidelines
- Promotes international convergence of standards

International auditing and assurance standards board

- Create international auditing standards (ISA), independent body under IFAC

International forum on Accountancy Development (IFAD)

- 产生于亚洲金融危机之后=〉aid developing nations
- Encourage conformity with IFRS
- Developed the International Financial Framework to aid in improving standards wit national financial frameworks.
- Conducted a GAAP Convergence survey

The international harmonization and disclosure debate

- Differences in reporting are due to differences in domestic needs
- More industrialized nations will not be totally supportive of increased regulation (enough regulation)
- Many countries=> protect their own biz community at the expense of others
- Future developments will be centered on MNEs
- May be less disclosure now<=complex nature of MNEs.

Reading

Article by: Barth, Mary E

Objective: The question we address is whether application of International Accounting Standards (IAS) is associated with higher accounting quality than application of non-U.S. domestic standards.

Perspectives: investigate whether accounting amounts of firms that apply IAS exhibit less earnings management, more timely loss recognition, and higher value relevance than accounting amounts of firms that apply domestic standards

Limitation:

1. First, IAS may be of lower quality than domestic standards.
   e.g.: limiting managerial discretion; inherent flexibility in principles-based standards

2. The effects of features of the financial reporting system other than the standards themselves could eliminate any improvement in accounting quality arising from higher quality accounting standards. --- The accounting reporting quality has been a high level.

Results: we find that firms applying IAS exhibit less earnings smoothing, less managing of earnings towards a target, more timely recognition of losses, and a higher association of accounting amounts with share prices and returns.

Article by: Chen, Huifa
Purpose: The purpose of this study is to examine the effect of IFRS adoption on accounting quality in the European Union (EU) – (15 member states of the European Union (EU) before and after the full adoption of IFRS)

Results:
1. Holding economic and political forces constant (management incentives), accounting standards make a difference in accounting quality.
2. Argue IFRS, with higher quality than national accounting standards, restrict or reduce alternative accounting choices
3. IFRS reduce the ambiguity and inconsistence of local standards, as it is easier to interpret and implement
4. IFRS would also improve financial reporting quality by changing managerial incentives.'

In sum, the accounting standards itself form part of the overall economic and political systems and institutions. Thus, changes in accounting standards also create incentives for manager to produce high quality financial reporting.

Article by Hope, Ole-Kristian
Purpose: We examine a group of institutional factors that might influence a country's decision to adopt IFRS: securities laws on security offerings, anti-director rights, and commitment to building a more accessible a capital market to foreign investors.

Results:
1. Countries with relatively weak investor-protection mechanisms in place might be more likely to adopt IFRS if they seek to improve their investor protection by 'bonding' to a reporting standard that provides more comparable and comprehensive financial information.
2. The adoption of IFRS is likely viewed as means to improve disclosure policies and accounting systems, to enhance the integration of domestic markets into world markets, and to subsequently accelerate economic growth.

Week 6 international financial reporting quality

Hope and Kang (2005) The association between macroeconomic uncertainty and analysts' forecast accuracy.
Objective: whether macroeconomic uncertainty affects the forecast accuracy of financial analysts in an international setting, where macroeconomic uncertainty is proxied by **inflation rate and exchange rate volatility.**

Findings:

- Forecast accuracy decreases in the level of macroeconomic uncertainty, there is a negative and significant association between macroeconomic uncertainty and forecast accuracy. 在宏观不确定性下准确预测降低
- The negative association between forecast accuracy and macroeconomic variables is more pronounced断言 for emerging economies than developed economies. investors should be aware that forecasts are likely to be less accurate in environments characterized by high macroeconomic uncertainty
- Results suggest that macroeconomic uncertainty represents a unique dimension in the complexities associated with predicting future firm performance. 宏观不确定性-〉预测公司表现
- **Conclusion：**
- **1. A negative and significant association between macroeconomic uncertainty and forecast accuracy.**
- 2. **The impact of macroeconomic uncertainty is greater for firms from emerging economies than for firms from developed economies.** 新兴经济更显著， 负相关
- Limitation:

1. Do not consider variations in individual analysts' abilities and resources (eg,Clement,et,al 2003). Unclear exante.
2. Limits the sample size; The sample firms have voluntarily chosen to be listed and traded in the US

H1: Macroeconomic uncertainty is associated with lower earnings forecast accuracy. 宏观经济不确定性降低盈利预测准确性

H2: The effect of macroeconomic uncertainty on forecast accuracy is greater in emerging economies than in developed economies

Hope O K (2003) Disclosure practices, enforcement of accounting standards, and analysts' forecast accuracy: An international study.

Objective: the associations between the accuracy of financial analysts' earnings forecasts and variations in firms' disclosures and enforcement of accounting standards.

Findings:

- Firm-level disclosures are positively related to forecast accuracy, suggesting that such disclosures provide useful information to analysts.
- Strong enforcement is associated with higher forecast accuracy. This finding is consistent with the hypothesis that enforcement encourages managers to follow prescribed accounting rules, which, in turn, reduces analysts' uncertainty about future earnings. 准确-〉执行
- Disclosures being more important when analyst following is low and with enforcement being more important when more choice among accounting methods is allowed. More specifically, annual report disclosures are more positively related to forecast accuracy when a firm is followed by few analysts, consistent with my hypothesis that the annual

report constitutes a relatively larger part of a firm's overall communication process when analyst following is low.

- Benefits of enforcement being greater in environments that allow for greater choice among accounting methods.
- Limitations: subject to certain limitations. 1. A potential disadvantage of using an international sample=〉很可能 affected by omitted correlated variables. 2. Potential to test for causality rather than mere associations is limited. 因果关系

Climate change

Motivation:

- Climate change is a complex phenomenon and a serious challenge, But the role of accounting for global warming is not made clear
- Companies do have incentives to alter their behavior via given the changes in government policy, customers preference and societal expectation.

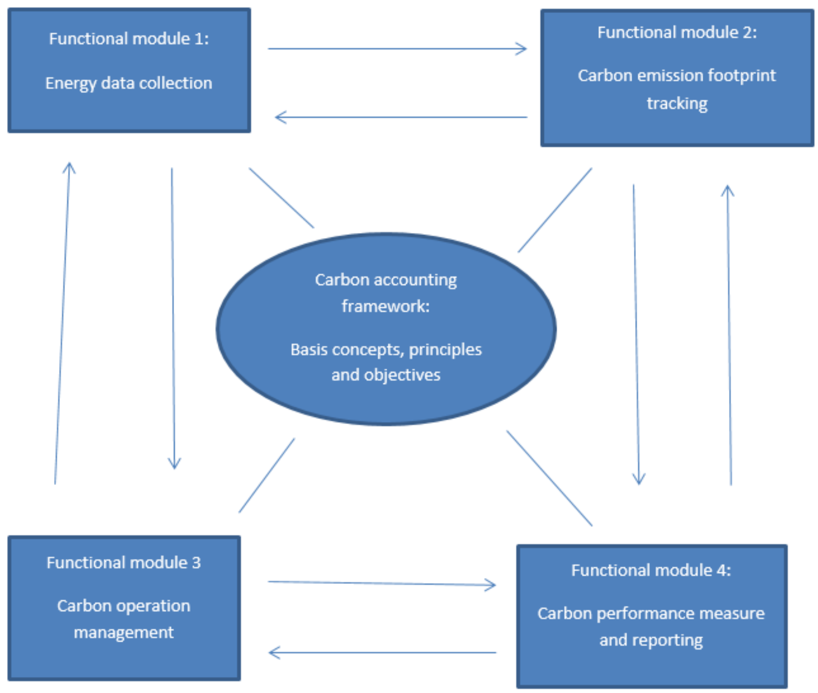
Carbon accounting

- **Definition:** *Carbon accounting is a system that uses accounting methods and procedures to collect, record, and analyse climate change related information, and account and report for carbon related assets, liabilities, expenses and income for the decision-making of internal managers and external stakeholders.*
- Carbon accounting is to min exposure to carbon risk and liability and reduce its operational carbon emissions.
- CA helps the managers who adopt a balanced policy btw max of firm value and environmental protection.
- Used to account for the externalities of CO2 emissions
- Under carbon tax system, the externality is measured by the carbon tax, which is a fixed carbon price.
- Consistency with Stakeholder theory
- Corporate governance may balance a firm’s financial and non-financial goals and moderate possible conflicting expectations of stakeholders who have disparate interests.
- Developed nations are more likely to disclose CO2 information, the findings are consistent with the resource dependence theory.
- Cost of capital is negatively associated with carbon disclosure, this relationship is weaker for firms with good carbon performance.
- **Objective: firms level**
  1. assist managers to formalize climate change strategy,
  2. identify and control climate change risks and opportunities,
  3. improve carbon management system

4. achieve carbon reduction targets

- **Objective: national level**
  1. Help the development of public climate policy
  2. Provides transparent carbon information, and GHG emissions assurance for carbon mkts
  3. essential inform for external users
- financial accounting, management accounting(e.g. carbon reduction cost control, carbon project budget, evaluation of carbon investment) and auditing(e.g. GHG statement assurance)
- **challenge**: carbon accounting also covers non-financial (so-called 'narrative') disclosure of corporate climate impact (Luo et al 2012) and carbon benchmarking
- **carbon assurance:**
  1. Datt (2013) voluntary GHG Statements contain managers' private information. So assurance can narrow information asymmetry in CO2 and activity even in financially transparent comp
  2. financial statements VS GHG Statements
  3. earnings management incentives VS greenwashing incentives
  4. financial information asymmetry VS carbon information asymmetry
- **ETS** 碳排放交易市场
  1. One of the major mechanisms to control CO2 in the world.
  2. Cap and trading system
  3. Emission right/ permit is a commodity which has a price in trading mkt
  4. Firms with its marginal cost of cutting one tone of carbon will reduce the emission itself, while firms with high cost of cut carbon can buy the right in carbon market.

- **Holistic 整体的 research approach:**
  1. Whole-part, focus on observation of the specimen 样本 within its ecosystem first before breaking down to study any part of the specimen. 以前的：systems by dividing them into smaller composing elements, through understanding their elemental properties.
  2. Multidisciplinary 多学科
  3. Concerned with the behavior of complex systems
  4. Recognize feedback within systems as a crucial element for understanding their behavior.



5.
A comprehensive and integrated view of carbon accounting system: Holistic approach

5. A summary of the roles of carbon accounting for carbon management systems

Major CMS elements*	Purpose	The role of carbon accounting
Board function	To develop an overall climate change strategy and policy	Carbon accounting provides adequate information for formalisation of carbon policy to address climate change issues.
Carbon Risk and opportunity assessment	To identify and assess carbon risk and opportunity	Carbon accounting is needed to design the procedure to assess climate risk and opportunity, particularly about its financial implications for firm operation and profitability.
Staff involvement and carbon performance evaluation	To motivate staff and enhance awareness of climate change issues	Carbon accounting method should be used to design specific measure required to incentivise them to participate in carbon reduction and energy saving projects.

Emission target	To create a mitigation target that is consistent with the carbon strategy	Carbon accounting should provide sufficient information for managers to set up measurable and quantifiable emission reduction target.
Carbon actions and policy implementation	To enforce the carbon policy by prioritising reduction actions and allocating resources to achieve targets	Carbon accounting should evaluate low carbon projects, energy efficiency project, clean energy initiatives. Carbon project needs specific funding, specific objectives so feasible study is needed.
Supply chain emission control	To reduce supply chain emissions	Carbon accounting is needed to develop specific measures to control supply chain emissions.
GHG emissions recording, accounting and internal reporting	To keep track of carbon inventory and emission footprint	Carbon accounting has specific and distinct protocol and standards and norms to account for emission including scope 1,2, 3. What is more, is the need to account for emission rights and its economic values of carbon assets and liabilities. Carbon accounting should prepare this report for the decision making of managers who is responsible to achieve carbon target.
External carbon assurance	To increase the reliability of carbon data	External and internal GHG emission assurance and verification is also needed to check carbon recording and energy consumption.
External disclosure	To increase the transparency of mitigation activities and outcomes, To strengthen the link with stakeholders	Carbon accounting should specify the contents, format and frequency of carbon disclosure to external stakeholders groups who care about emissions. So many firms prepared stand-alone GHG report.

6. The 5 steps of the development of carbon management system
    - Carbon strategy development
        1. Analysis of impact of government climate policy
        2. Review of low carbon technology and mkt
        3. Assessment of internal management and institutional capacity
    - Carbon risk & opportunity assessment and financial impact
        1. Assessment of regulatory and physical risks
        2. Assessment of product and process risk
        3. Assessment of mkt risk and consumer preference
        4. Assessment of supply chain risk
    - The development of carbon management system-carbon target setting
        1. Analysis of historical date of energy consumption
        2. Review of national target and industry level emissions
        3. Financial commitment of reduction targets
    - Develop and implementation of carbon program
        1. Feasibility study
        2. Budget
        3. Cost control techniques
    - Carbon performance evaluation and reporting
        1. Measure of carbon performance at the firm level, department and individual staff level
        2. Internal and external carbon reporting and disclosure
        3. Carbon assurance
    - What is known and what is unknown?

The Kyoto framework

The Kyoto framework is a cap and trade system in which each country is allowed a certain level of emissions during the first commitment period (which runs from 2008 to 2012). If a country doesn't hit its targets during this period they have to provide a reduction of 1.3 tons in the future for each tone of carbon they exceed their target.

Carbon emissions trading and why we need green accounting?

In order to reduce carbon emissions reductions, emissions trading schemes are designed to achieve the target through the use of tradable emission permits. The purpose of the scheme is to allow an entity that can reduce emissions below their own targets at lower cost sell their emission permits to others for whom emissions reductions are more costly, thereby reducing the overall cost of emissions reductions. Pollution trading markets in which carbon offsets are traded, have became a major mechanism to reduce CO2 emissions, which are responsible for about 60% of the total greenhouse effect. These events have created a great demand for carbon emissions accounting or so called green accounting.

Objectives of Green Accounting

The objectives of Green Accounting is to establish basic methods for carbon emission calculation, accounting for environmental assets and liabilities; disclosure of greenhouse gas emission control and reduction activities; greenhouse gas emission assurance and auditing and other environmental related issues, such as taxation, etc.

Carbon emission calculation

- Step 1: Determine the amount of fossil fuel used per year
- Step2: calculating carbon emissions from fossil fuel combustion (calculation the associated carbon emissions per year)
- Step3: calculate the land area needed to absorb those carbon emissions

Accounting methods for environmental assets and liabilities

Currently there is no accounting standard in this area. The IASB and the FASB are conducting a joint project to develop comprehensive guidance on the accounting for emissions trading schemes. There was a risk of diverse accounting practices for such schemes (without an international accounting standard) and this would impair the comparability and usefulness of financial statement information.

The main issues are the recognition and measurement of the assets and liabilities in an emissions trading scheme, particularly, an entity receives emission allowances from the scheme administrator for no monetary consideration.

Disclosure of carbon emission and reduction activities

Mandatory Disclosure- Australian corporations are required to report greenhouse gas emissions (GHG) under the *National Greenhouse and Energy Reporting Act 2007* (the NGER Act). CDP

How to measure corporate exposure to carbon risk?

- COST METHOD
- REVENUE METHOD (OUTPUT SENSITIVITY TO CARBON RISK)
- CARBON QUANTITY METHOD
- PROJECT METHOD
- FOR MULTINATIONAL ENTERPRISES
- FOR DIVERSIFIED COMPANIES

What can accounting do to stabilize climate change?

- Accounting is under the control of companies and companies are held to be responsible for the damage of environment.

- Accounting as an element of the mkt system is unlikely to play a role for environmental protection. Fundamental reform to the mkt mechanism.

Why China is so important in carbon emission?

- China's previous unwillingness to commit to specific dates and targets has been a serious stumbling block in attempts to persuade the US to make commitments of its own.
- China now believes trying to curb its emissions is in its own best interests – atmospheric pollution in China, especially from burning coal, has become a major political issue that now demands action.
- If the world's two largest economies manage to work together on research and development in areas such as renewable power generation and distribution, and electric vehicles, these "green" industries could see huge new investment in the next few years.

Week 7 Influence of Culture on EM

Reading (Timothy s.Doupnic)

This article examines the influence of national culture on earnings management across a broad cross-section of countries. Indicates two different types of earnings management: earnings smoothing and earnings discretion. Five dimension of culture: Uncertainty avoidance, individualism, power distance, masculinity, long-term orientation.

Results:

1. Regression results indicate that the cultural dimensions of uncertainty avoidance and individualism are significantly related to earnings management**. Earnings smoothing is increasing in UA (正比) and decrease in Individualism (反比).**
2. Masculinity on earning smoothing was unclear and not significant. Power distance and long-term orientation also not significant in earnings management.
3. Culture has a stronger relation with earnings smoothing than with earnings discretion.
4. A directional relation was posited between earnings discretion and each of Hofstede's cultural dimensions. However, no significant relation between culture and earnings discretion except uncertainty avoidance.

Reading (Christian Leuz)

This paper examines systematic differences in earnings management across 31 countries. Explanation based on insiders- attempt to protect their private control benefits and earnings management-conceal 隐藏 firm performance.

Findings:

1. Earning management is decrease in investor protection because strong protection limits insiders' ability to acquire private control benefits.
2. Our descriptive evidence suggests that firms in countries with developed equity markets, dispersed ownership structures, strong investor rights, and legal enforcement engage in less earnings management.

Chapter 2

Deductive approach: 演绎法

Gerhard Mueller in his book International Accounting (1967) identify four approaches to accounting development:

1' in macroeconomic pattern, business accounting correlates closely with national economic policies. The goal of corporation usually follow rather than lead national economic policies.

2' in microeconomic pattern, accounting is viewed as branch of business economic.

3' in the independent discipline pattern, accounting is viewed as a service function and is derive from business practice.

4' in the uniform accounting pattern, accounting is viewed as an efficient means of administration and control.

Inductive Approach: 归纳法

Nair and Frank (1980) findings

- Hypotheses not supported groups.

Overall – little attention given to influence of culture.

Hofstede's Societal Dimensions

- Individualism VS Collectivism
- Large VS small power distance
- Strong VS Week uncertainty Avoidance
- Masculinity VS Femininity
- Confucian dynamism

Accounting values-Gray

- Professionalism vs statutory control: Link to societal value dimensions – Professionalism: Individualism; Weak uncertainty avoidance; Small power distance; Masculinity; Short-term orientation
- Uniformity vs flexibility: Link to societal value dimensions – Uniformity: Strong uncertainty avoidance; Collectivism; Large power distance
- Conservatism 保守主义 vs optimism：Link to societal value dimensions – Conservatism: Strong uncertainty avoidance; Long-term orientation; Collectivism 集体主义; Femininity
- Secrecy vs transparency：Link to societal value dimensions – Secrecy: Strong uncertainty avoidance; high power distance; Collectivism; Femininity

Accounting values and international classification

- ➢ Accounting values most relevant to professional or statutory authority and enforcement
- Professionalism and uniformity
- Both concerned with regulation and degree of enforcement or conformity
- ➢ Accounting values most relevant to measurement and disclosure
- Conservatism and secrecy
- ➢ Country groupings
- Optimistic乐观主义 and transparent
- Conservative and secretive秘密的

Week 4 Foreign Currency Transactions - PartⅡ

1. Foreign exchange can be traded "over –the –counter" (OTC), on an exchange or over the internet. The OTC market is composed of commercial banks (bank of America) and investment bank. Denominated in currency,非 reporting 时才 currency; if transaction is settled immediately, the transaction is recorded at the spot rate.
2. spot 即期交易(within 2 business day); Outright forward (直接远期交易) 3 or more days after; FX swap market (调期外汇交易)
3. Future traded on an exchange   options traded on OTC or securities exchange
4. A future K is an agreement between 2 parties to buy or sell a particular currency at a particular price on a particular future date
5. Foreign currency transactions are transactions denominated in a currency other than the reporting currency of the firm. The reporting currency is the currency in which the firm's financial statements are issued
6. When a transaction is denominated in a foreign currency and payment is settled at subsequent balance sheet date 随后付, the firm needs to resolve 4 problems:

(1) the initial recording of the transaction 原始交易记录
(2) the recording of foreign currency balances at subsequent balance sheet dates 在随后资产负债表日的外币余额记录
(3) the treatment of any foreign exchange gains and losses 汇兑损益
(4) the recording of the settlement of foreign currency receivables and payables when they come due 应收和应付外币货款在到期时处理

7. Any foreign currency transaction has 2 components: the monetary component (cash received, a/c receivable) and the non-monetary component (equipment/inventory purchased or sold).
8. The translation problem: appropriate foreign currency exchange rate to use translation transaction? (historical rate? Closing rate? Lower of the historical rate and the closing rate?) Gain/lost that arises when exchange rates change; translation of transactions VS translation of financial statements.
9. The IASB 国际会计准则委员会 adopted IAS21 and FASB 财务会计准则委员会 use SFAS52
10. Where foreign exchange gains and losses are recognized in income at each balance sheet date
11. Any difference between the previous and new spot rate is a gain or loss recognized in the current accounting period.
12. IAS21 requires transactions to be initially recorded at the spot rate **on the date** of the transaction, at subsequent balance sheet dates:

(1) monetary items should be recorded at the **closing rate**
(2) Non-monetary items **carried at historical cost should be recorded at the historical exchange rate**.
(3) Non-monetary items **carried at fair value** should be recorded **at the rate in effect** when the fair values were determined

13. All foreign currency balance sheet and income statement accounts are **restated in terms of reporting currency by multiplying the foreign currency amount by the appropriate exchange rate.** The 4 methods is historically in the translation process are the current/ non-current, the monetary/ nonmonetary, the temporal, and the curate rate method.
    1. **Current method (closing rate method):**
        - ✓ Current assets and liabilities are translated at **current exchange rates**; noncurrent A&L &E are translated **at historical exchange rates**;
        - ✓ Anything due to mature in one year or less or within the normal business cycle should be translated at the **current rate**.
        - ✓ Everything else should be carried at the rate in effect when the translation was originally recorded;
        - ✓ Accounts should be grouped according to maturity
    2. **The monetary/ nonmonetary**
        - ✓ Monetary A & L translated at the current rate
        - ✓ Nonmonetary A&L & E translated at historical rates
        - ✓ A&L are translated on the basis of attributes instead of time.
    3. **Temporal method**:
        - ✓ Cash, receivables, and payables are translated at the current rate
        - ✓ Other assets and liabilities may be translated at current or historical rates, depending on their characteristics
        - ✓ Assets and liabilities carried at past exchange prices are translated at historical rates
        - ✓ Assets and liabilities carried at current purchase or sales exchange prices or future exchange prices would be translated at current rates
        - ✓ Branches and subsidiaries of a parent coy would be translated into the **parent currency** in such a way that a parent currency would be the single unit of measure.
    4. **Current rate method:**
        - ✓ Only net worth would be translated at the **historical rate**.
        - ✓ The current rate approach results in translated statements that retain 保持 the same ratios and relationships that exist in the local currency
        - ✓ All A&L are translated at the current exchange rate

14. International accounting standard: if the foreign operations are integral 完整的 to the operations of the reporting enterprise, the **temporal method** is used to translate financial statements into the reporting currency. When the foreign operations is considered to be a foreign entity, using the closing rate method.
15. The impact of IAS 21

    Requires disclosure of the following:

    - ✓ Amount of **exchange differences** included in the net profit or loss for the period
    - ✓ Net exchange differences classified as **equity** as a separate component of equity; a **reconciliation** of the amount of such differences at the beginning and end of the period

- ✓ If the reporting currency is different from the currency of the country in which the enterprise is domiciled, must disclose **the reason for using a different currency**
- ✓ The reason for any change in reporting currency
- ✓ A change in the functional currency of either the reporting entity or a significant foreign operation and the reason therefore

16. Factors influencing the determination of the functional currency:

(1) Cash flow indicators (2) sales price indicator (3) sales market indicator (4) expense indicators (5) financing indictor

If transaction is settled immediately, the transaction is recorded at the spot rate

1. Transaction 指的是交易本身；Translation 指的是从外币翻译成报告货币的过程.
2. 名词解释

   Functional currency – currency of the primary economic environment in which the company operates

   Reporting currency – currency in which the parent company prepares its financial statements

   Foreign currency – any currency other than the functional currency of the company 另一国

   Local currency – currency of a particular country being referred to

   Exchange difference – difference resulting from translating a given number of units of one currency into another currency at different exchange rates

   Foreign operation – a subsidiary, associate, joint venture, or branch whose activities are based in a country other than that of the reporting enterprise

3. Translation of transactions:

   i **Initial recoding: use the rate at the day of transaction * transaction amount**

   ii Subsequent recording:

   - **Monetary items** (cash received/paid or accounts receivable/payable):

     Use the closing rate (rate at the balance sheet day) * transaction amount

   - **Non-monetary items** (equipment or inventory purchased or sold):

     Recorded at the historical rate; or

     If it carried at fair value, it should be recorded at the rate in effect when the fair values were determined

   iii Any **difference between the spot rates is a gain or loss**, reflected in the period in which the rate changed, and is recognized as **INCOME** (IAS 21 and SFAS 52).

4. Illustration

Example 1

Australian firm imports equipment from Germany on March 1 for €200,000 when the exchange rate is $1.3112 per euro. Payment in Euro does not have to be made until April 30. Assume that on March 31, the exchange rate is $1.35 and on

April 30 is $1.33. The firm's books are closed at the end of the calendar quarter.

Journal Entries

Mar. 1	Dr Purchases (Equipment)	262,240	
	Cr A/P		262,240
	€200,000 * 1.3112		

Mar. 31	Dr Foreign exchange loss	7,760	
	Cr A/P		7,760
	€200,000 (1.3112 – 1.35)		

Apr. 30	Dr A/P (262,240 + 7,760)	270,000	
	Cr Foreign exchange gain		4,000
	Cr Cash (200k * 1.33)		266,000

Example 2 - Accounting for Debt in a Foreign Currency

On January 1, an Australian firm borrows 2 million foreign currency (FC) for 5 years at 3% interest paid semi-annually in FC. The principal does not have to be repaid until the end of the loan. The loan is adjusted for exchange rate changes every 6 months.

Exchange rates are:

January 1	$.8064	Average (1st 6 months) $.79825
June 30	$.7901	Average (2nd 6 months) $.8370
December 31	$.8839	

Journal Entries:

Jan. 1	Dr Cash	1,612,800	
	Cr Notes Payable		1,612,800
	2,000,000 *0.8064		

Jun. 30	Dr Notes Payable	32,600	
	Cr Foreign Exchange Gain		32,600
	(0.7901-0.8064) * 2million		

Jun. 30	Dr Interest Expense	23,948	
	Cr Foreign Exchange Gain		245
	Cr Cash		23,703
	2million * 1.5% = 30,000 * 0.79825 = 23,948; 30,000* 0.7901 = 23,703		

Note: expense 如果未特殊说明，一般都是用 average rate

Dec. 31	Dr Foreign exchange loss	187,600	
	Cr Notes Payable		187,600
	(0.7901-0.8839) * 2million		
Dec.31	Dr Interest Expense	25,110	
	Dr Foreign Exchange Loss	1,407	
	Cr Cash		26,517
	30,000 * 0.8370 = 25,110; 30,000* 0.8839 = 26,517		

5. Methods for translation (曾经使用过的)

	Current/ Non-Current Method	Monetary / Non-monetary Method	Current Rate Method (Closing Rate Method)	Temporal Method
Asset & Liability	Current→ Current rate Non-current→ Historical rate	Monetary→ Current rate Non-monetary→Historical rate	Current rate	Cash, receivables, and payables→ Current rate Others carried at past prices→ Historical rates Others carried at current or future prices→ Current rates
Equity	Historical rates	Historical rate		
Net worth			Historical rate	
Where & When Apply	US: early 30s-75	US: 50s, the attitude of US began to change to this method		Originally proposed by AICPA; Conformed by US in 1975
Evaluation	Assumption: Accounts should be grouped according to maturity	Supporter: It is more meaningful to translate assets and liabilities on the basis of attributes	Easiest The ratio of net income to sales would remain the same in the reporting currency as in the foreign currency	Flexible

IFRS v US GAAP re Rawl Corporation

Rawl Corporation is a U.S based company that prepares its consolidated financial statements in accordance with U.S GAAP. The company reported income in 2008 of $1,000,000 and stockholders' equity at December 31, 2008, of $8,000,000.

The CFO of Rawl has learned that the U.S Securities and Exchange Commission is considering giving U.S companies the option of using either U.S GAAP or IFRS in preparing consolidated financial statements. The company wishes to determine the impact that a switch to IFRS would have on its financial statements and has engaged you to prepare a reconciliation of income and stockholders equity from U.S GAAP to IFRS. You have identified the following six areas in which Rawl's accounting principles based on U.S GAAP differ from IFRS.

1. Inventory
2. Property, plant and equipment
3. Intangible assets
4. Research and development costs
5. Sale and leaseback transaction
6. Pension plan

Rawl provides the following information with respect to each of these accounting differences.

Inventory

At year-end 2008, inventory had a historical cost of $250,000, a replacement cost of $180,000, a net realizable value of $190,000, and the normal profit margin was 20 percent.

Property, Plant, and Equipment

The company acquired a building at the beginning of 2007 at a cost of $2,750,000. The building has an estimated useful life of 25 years, an estimated residual value of $250,000, and is being depreciated on a straight-line basis. At the beginning of 2008, the building was appraised and determined to have a fair value of $3,250,000.There is no change in estimated useful life or residual value. In a switch to IFRS, the company would use the revaluation model in IAS16 to determine the carrying value of property, plant and equipment subsequent to acquisition.

Intangible Assets

As part of a business combination in 2005, the company acquired a brand with a fair value of $40,000. The brand is classified as an intangible asset with an indefinite life. At year end 2008, the brand is determined to have a selling price of $35,000 with zero cost to sell. Expected future cash flows from continued use of the brand are $42,000 and the present value of the expected future cash flows is $34,000.

Research and Development Costs

The company incurred research and development costs of $200,000 in 2008. Of this amount, 40 percent related to development activities subsequent to the point at which criteria had been met indicating that an intangible asset existed. As of the end of the 2008, development of the new product had not been completed.

Sale and Leaseback

In January 2006, the company realized a gain on the sale and leaseback of an office building in the amount of $150,000. The lease is accounted for as an operating lease and the term of the lease is 5 years.

Pension Plan

In 2007, the company amended its pension plan creating a past service cost of $60,000. Half of the past service cost was attributable to already vested employees who had an average remaining service life of 15 years, and half of the past service cost was attributable to non-vested employees who on average had two more years until vesting. The company has no retired employees.

Required

(1) Prepare a reconciliation schedule to convert 2008 income from a U.S. GAAP basis to IFRS. Ignore income taxes. Prepare a note to explain each adjustment made in the reconciliation schedule.

(2) Prepare a reconciliation schedule to convert shareholders' equity at December 31, 2008, from a U.S. GAAP basis to IFRS. Ignore income taxes. Prepare a note to explain each adjustment made in the reconciliation schedule.

IFRSvsUS GAAP

Reconciliation from U.S. GAAP to IFRS

	2008
Income under U.S. GAAP	**$1,000,000**
Adjustments:	
Reversal of writedown of inventory to replacement cost	10,000
Additional depreciation on revaluation of equipment	(25,000)
Impairment loss on intangible asset (brand)	(5,000)

Recognition of deferred development costs	80,000
Reversal of amortization of deferred gain on sale and leaseback	(30,000)
Difference in amortization of prior service cost	(11,000)
Income under IFRS	**$1,019,000**

	2008
Stockholders' equity under U.S. GAAP	**$8,000,000**
Adjustments:	
Reversal of writedown of inventory to replacement cost	10,000
Original revaluation surplus on equipment	600,000
Accumulated depreciation on revaluation of equipment	(25,000)
Impairment loss on intangible assets (brand)	(5,000)
Recognition of deferred development costs	80,000
Recognition of gain on sale and leaseback in 2006	150,000
Accumulated amortization of deferred gain on sale and leaseback (2006-2008)	(90,000)
Difference in cumulative amortization of prior service cost	(52,000)
Stockholders' equity under IFRS	**$8,668,000**

Explanation of Adjustments

Inventory. Under U.S. GAAP, the company reports inventory on the balance sheet at the lower of cost or market, where market is defined as replacement cost ($180,000), with net realizable value ($190,000) as a ceiling and net realizable value less a normal profit ($152,000) as a floor. In this case, inventory was written down to replacement cost and reported on the December 31, 2008 balance sheet at $180,000. A $70,000 loss was included in 2008 income.

In accordance with *IAS 2*, the company would report inventory on the balance sheet at the lower of cost ($250,000) and net realizable value ($190,000). Inventory would have been reported on the December 31, 2008 balance sheet at net realizable value of $190,000 and a loss on writedown of inventory of $60,000 would have been reflected in net income.

IFRS income would be $10,000 larger than U.S. GAAP net income. IFRS retained earnings would be larger by the same amount.

Equipment. Under U.S. GAAP, the company reports depreciation expense of $100,000 [($2,750,000 – $250,000) / 25 years] in 2007 and in 2008.

Under *IAS 16*'s revaluation model, depreciation expense on equipment in 2007 was $100,000, resulting in a book value at the end of 2007 of $2,650,000. The equipment then would be revalued upward at the beginning of 2008 to its fair value of $3,250,000.

The appropriate journal entry to recognize the revaluation would be:

Dr. Equipment	$600,000	
Cr. Revaluation Surplus (a stockholders' equity account)		$600,000

In 2008, depreciation expense would be $125,000 [($3,250,000 - $250,000)/24 years].

The additional depreciation under IFRS causes IFRS-based income in 2008 to be $25,000 smaller than U.S. GAAP income. IFRS-based stockholders' equity is $575,000 larger than U.S. GAAP stockholders' equity. This is equal to the amount of the revaluation surplus ($600,000) less the additional depreciation in 2008 under IFRS ($25,000), which reduced retained earnings.

Intangible Assets. Under U.S. GAAP, an asset is impaired when its carrying amount exceeds the undiscounted future cash flows expected to arise from continued use of the asset. The brand acquired in 2005 has a carrying amount of $40,000 and future expected cash flows are $42,000, so it is not impaired under U.S. GAAP.

Under IAS 36, an asset is impaired when its carrying amount exceeds its recoverable amount, which is the greater of net selling price and value in use. The brand's recoverable amount is $35,000; the greater of net selling price of $35,000 and value in use (present value of future cash flows) of $34,000. As a result, an impairment loss of $5,000 would be recognized under IFRS.

IFRS income and retained earnings would be $5,000 less than U.S. GAAP income and retained earnings.

Research and Development Costs. Under U.S. GAAP, research and development expense in the amount of $200,000 would be recognized in determining 2008 income.
Under *IAS 38*, $120,000 (60% x $200,000) of research and development costs would be expensed in 2008, and $80,000 (40% x $200,000) of development costs would be capitalized as an intangible asset (deferred development costs).

IFRS-based income in 2008 would be $80,000 larger than U.S. GAAP income. Because the new product has not yet been brought to market, there is no amortization of the deferred development costs under IFRS in 2008.

Sale and Leaseback. Under U.S. GAAP, the gain on the sale and leaseback (operating lease) is recognized in income over the life of the lease. With a lease term of five years, $30,000 of the gain would be recognized in 2008. $30,000 also would have been recognized in 2006 and 2007, resulting in a cumulative amount of retained earnings at year-end 2008 of $90,000.

Under *IAS 13*, the entire gain on the sale and leaseback of $150,000 would have been recognized in income in 2006. This resulted in an increase in retained earnings of $150,000 in that year. No gain would be recognized in 2008. IFRS income in 2008 would be $30,000 smaller than U.S. GAAP income, but stockholders' equity at December 31, 2008 under IFRS would be $60,000 larger than under U.S. GAAP.

Pension Plan. Under U.S. GAAP, the prior service cost is amortized over the remaining service life of the employees. Expense recognized in 2008 is $4,000 [$60,000 / 15 years]. The cumulative expense (and reduction in retained earnings) recognized since the plan was changed in 2007 is $8,000 [$4,000 x 2 years].

Under *IAS 19*, the prior service cost attributable to the vested employees would have been expensed in 2007 – $30,000 [50% x $60,000]. The prior service cost attributable to non-vested employees would be expensed over the two remaining years until vesting. Expense recognized in 2008 would be $15,000 [$30,000 / 2 years]. The cumulative expense (and reduction tin retained earnings) recognized since the plan was changed is $60,000 [$30,000 + ($15,000 x 2 years).

IFRS income in 2008 would be $11,000 ($15,000 - $4,000) less than U.S. GAAP income, and stockholders' equity at year-end 2008 under IFRS would be $52,000 ($60,000 - $8,000) less than under U.S. GAAP.

Week 2 Corporate governance

Globalization refers to the deepening relationships and broadening interdependence among people from different countris.

Out, Porter, and Rudden suggest that companies that are more likely to adopt a multidomestic strategy are those that have products that differ greatly from country market to country market.

The first major document aim at improveing governance practices was issued in the US in January 1978 was entitled *The role and composition of the board of directors of large publicly owned corporation.*

Egelhoff(1991) identifies four dimensions or types of infomation processing that are relevant for MNEs: Routine(frequent and homogeneous), Nonroutine(unique and infrequent), Sequential(predetermined), Reciprocal(back and forth).

Summary:

1. MNEs typically adopt a multidomestic, global or transnational strategy to face the opportunities and challenges of globalization
2. Informal and subtle mechanisms are becoming increasingly more important means of managing MNEs.
3. A firm's structure reflects its strategy. As a firm goes from purely domestic to truly global, it progressively moves from a domestic structure to ana international division structure and finally to a truly global structure.
4. Corporate goernance exists to determine the relationships between the various stakeholders in a firm, how resources will be allocated, and how conflicts among the stakeholders will be resolved.
5. Internal governance mechanisms include the board of directors and the ownership structure of the firm. External mechanisms include the takeover market and the legal system in which the firm operates.
6. The board of directors plays a key role in monitoring management performance and representing the interests of shareholders.
7. Globalization along with the failure of large corporations has triggered the creation of Codes of Best Practice in governance in all major markets worldwide.

8. The interplay of emplyees, managers, and shareholders faced with different cultural, legal, and financial systems.
9. Internal control is one of the key responsibilities of the board of directors and management. Internal control is a process designed to achieve the companies' objectives in three key areas: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulation.
10. The Sarbanes-Oxley Act of 2002 has far-reaching effects on the internal controls of MNEs.
11. Information technology is a key aspect of maintaining a sound internal control and acc system. ERP and the Internet are effective tools for transmitting info in MNEs.
12. Bartlett and Ghoshal(1989) identify three global imperatives that influence organizational structure, the degree of centralization of decision making and the orga culture of the firm: 1'forces for global integration: the need for efficiency. 2'forces for local differentiation: the need for responsiveness3'forces for worldwide innovation: the need for learning.
13. Agency theory arises due to the: Separate legal status of a corporation; Separation of ownership and management. Agency theory is the theory most used to justify corporate governance reform
14. Insider trading is Prohibited under Corporations Act.

15. Roles of the Board of Directors: Hire, control, and fire management ! Determine management's compensation ! Composed of multiple committees ! Board members are appointed by the owners! Should have a majority of "outside" members.

大家自己再做一下Lisia那道题!

Week 1:

Multiple choices:

- **The impact of multiple listing of companies on accounting and financial reporting:** language, currency, accounting standards, auditing standards and disclosure.

  Questions for Foreign operations of multinational corporations:
- How to account for foreign operations
- How to disclose foreign activities
- **Scope of International accounting:**
  1. **Multinational corporation accounting**
  The focus is on the accounting problems faced by multinational companies' problems Addressed: How to deal with foreign exchange problem & How to consolidate foreign subsidiaries in group account
  2. **Comparative international accounting**
- Focus is on accounting problems faced by local investors
- Problems addressed: Differences between national accounting standards &
- Convergence/Harmonization of accounting standards.

Week 8 Successful auditing

Successful auditing has three important requirements:

1. an objective(independent), competent person
2. quantifiable(and verifiable) information
3. established criteria(or auditing standards)

The quality of auditing profession in each country is a function of several factors, such as the reputation of the accounting and auditing profession, the quality of the educational system, and the certification process.

Auditing in the international context is a challenging task because of the differences in local business practices and customs; currency, language and law; distance and organizational issues; and the availability of suitable personnel.

The international audit industry is characterized by concentration by a few large firms. The Big Four, the world's largest accounting firms, are responsible for auditing most of the largest MNEs.

A major development in the global strategies of the world's largest auditing firms in recent years has been the merger of firms to form larger auditing firms that are better able to audit global corporations.

The international Federation of Accountants (IFAC) is attempting to harmonize auditing standards and practices so that financial statement users worldwide can be confident of the accuracy and reliability of the underlying financial statements. It helps increase confidence of investors in the reliability of financial statements.

Reading (Yang, Lloyd)

One of the objectives of setting accounting and auditing standards, ethical rules, or guidelines is to resolve conflicts (such as improper accounting treatment, presentation, or disclosure) that rise between auditors and clients.

It is expected that the Chinese accounting profession will soon be one of the largest in the world.

In a recent paper, Xiang (1998) indicates that harmonization with International Accounting Standards will be difficult in China because local auditors are not perceived as being independent.

Findings:

- This program has resulted in Chinese CPA firms being exposed to business risk, and having to face unlimited or limited liability if negligent in the performance of their duties.

Audit firm associations with the government can impair auditor independence, and that severing this connection is the first and crucial step towards the creation of a truly independent Chi

Week 3 Accounting Issues in Global Financial Crisis - Part Ⅰ

1. *Securitisation* – the banks re-packaged and re-sold sub-prime loans to each other, i.e. turned mortgage loans into marketable securities. Banks borrowed funds at law rate and sub-prime mortgagees at high rate.

2. Dodd–Frank Wall Street Reform and Consumer Protection Act - US 2010

   One key provision of the Act is the separation of investment banking from commercial banking, known as **Volcker rule**, which forbid commercial banks to speculate with protected deposits through trading securities.
   Under the new rules on capital, known as **Basel 3**, banks are required to hold more capital, minimum capital is to rise from 8% to 10.5% by 2019
3. European Commission made a decision to regulate bankers' bonuses in a bid to limit risk-taking activities.

Author: La Porta, Rafael

Title: Law and Finance

- Legal systems affect the state of corporate finance
- Common-law countries give investors more legal rights and protection than code-law countries do.
- The concentration of ownership is negatively correlated to the quality of legal protection of investors. Poor investor protection is associated with high concentrated ownership.
- The legal systems affect corporate governance. The findings of the paper suggest that investors have to adapt to the limitations of the legal systems that they operate in. They attempt to hold more shares in response to the lack of legal protections of their interest. Common-law countries generally have the strongest, and French-civil-law countries the weakest, legal protections of investors, with German- and Scandinavian-civil-law countries located in the middle.
- Concentration of ownership of shares in the largest public companies is negatively related to investor protections, consistent with the hypothesis that small, diversified shareholders are unlikely to be important in countries that fail to protect their rights.
- Differences in legal protection of investors may explain the differences in firms' ownership structure and finance via the capital markets
- Three key research measures:
  1) <u>Investor protection measure</u>: shareholder rights and creditor rights;
  2) <u>legal enforcement measure</u>: efficiency of the judicial system, rule of law, corruption, risk of expropriation (forced nationalization), likelihood of contract repudiation by the government, and quality of financial reporting
  3) <u>Ownership concentration measure</u>: the combined (cash flow) ownership stake of three largest shareholders for 10 non-financial, public companies in each country in the sample.
- Financial reporting provides reliable information on the company's financial state of affairs for investors
- Financial reporting is a corporate governance mechanism relied upon by investors to monitor management. Contracts between investors and manager typically rely on the verifiability in court of firm's income or assets and liabilities etc.

4. **Author: Liao, Lin**

Title: Information asymmetry of fair value accounting and loan loss provisions during the global financial crisis

- The relationship between information asymmetry and fair value estimates for US banks in 2008 is positive.
- The relationship between credit loss provisions and information asymmetry is positive.
- Fair value assets and liabilities are non-transparent and lead to information risk.
- Loan loss provisions have a stronger impact when compared with fair value estimates on market uncertainty.
- SFAS 157 is not effective and should be reviewed

Week 10 (Reading)

Purpose: This paper aims to study an unresolved issue in the literature on whether the strength of a country's legal system increases or decreases the governance role of auditors.

Results: On the one hand, weak legal environments may lessen auditors' governance role, making the auditor less able to serve as a bonding mechanism to mitigate agency costs or as a signalling tool for communicating with outside investors. On the other hand, auditors may play an even stronger governance role in countries with weak legal environments.