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FACULTY OF MANAGEMENT SCIENCES

INTERNATIONAL ACCOUNTING

ACC426

Course Guide

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CONTENT

Introduction

Course Aim

Course Objectives

Study Units

Assignments

Tutor Marked Assignment

Final Examination and Grading

Summary

INTRODUCTION

You are holding in your hand the course guide for ACC426(International Accounting). The purpose of the course guide is to relate to you the basic structure of the course material you are expected to study as a B.Sc. Accounting Student in National Open University of Nigeria. Like the name 'course guide' implies, it is to guide you on what to expect from the course material and at the end of studying the course material.

COURSE CONTENT

The course content consists basically the practice of international accounting and the provisions of accounting standards. Specifically, an introduction to international accounting, International Accounting Standards and Organizations, accounting for multinational corporations, and accounting for foreign companies were the main focus of this course material.

COURSE AIM

The aim of the course is to bring to your cognizance the practice of international accounting, the causes of diversity in accounting practices around the world, and the consolidation and presentation of financial statements of foreign companies as regards issues in international accounting appropriate at this level.

COURSE OBJECTIVES

At the end of studying the course material, among other objectives, you should be able to:

1. Explain the concept of international accounting
2. Discuss the factors influencing accounting development globally.
3. Discuss the origin and causes of national differences in accounting
4. Discuss the reasons and obstacles for harmonization of accounting standards
5. Explain the roles of IASB and other bodies in the harmonization of accounting standards
6. Discuss the history of accounting standards in Nigeria
7. Discuss the accounting issues of multinational corporations
8. Highlight the techniques of financial statements analysis
9. Discuss the methods of financial statements translation
10. Translate the financial statements of a branch and foreign subsidiary

COURSE MATERIAL

The course material package is composed of:

The Course Guide

The study units

Self-Assessment Exercises

Tutor Marked Assignment

References/Further Reading

THE STUDY UNITS

The study units are as listed below:

Module 1: Introduction to international accounting

Unit 1: Historical background to international accounting

Unit 2: The concepts of international and universal accounting

Unit 3: International harmonization of accounting standards

Module 2: International accounting standards and organizations

Unit 1: International accounting standard setting bodies and organs

Unit 2: Adoption of IFRS in Nigeria

Module 3: Accounting for multinational corporations

Unit 1: The multinational corporations

Unit 2: Presentation and analysis of financial reports by multinational corporations

Unit 3: Performance evaluation in MNCS

Module 4: Accounting for foreign operations

Unit 1: IAS 21 and reporting foreign currency transactions in the functional currency

Unit 2: IAS 21 and financial statement translation of foreign operations: foreign branches

Unit 3: IAS 21 and financial statement translation of foreign operations: consolidated financial statements

ASSIGNMENTS

Each unit of the course has a self assessment exercise. You will be expected to attempt them as this will enable you understand the content of the unit.

TUTOR MARKED ASSIGNMENT

The Tutor Marked Assignments (TMAs) at the end of each unit are designed to test your understanding and application of the concepts learned. Besides the preparatory TMAs in the course material to test what has been learnt, it is important that you know that at the end of the course, you must have done your examinable TMAs as they fall due, which are marked electronically. They make up to 30 percent of the total score for the course.

SUMMARY

It is important you know that this course material was designed by the author with adaptations from various works as duly referenced. This provides you the opportunity of obtaining a BSc. degree in Accounting and preparation for your professional examinations. Therefore, it is very important that you commit adequate effort to the study of the course material for maximum benefit. Good luck.

INTERNATIONAL ACCOUNTING

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Main Content

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TABLE OF CONTENT

Content

MODULE 1: INTRODUCTION TO INTERNATIONAL ACCOUNTING

UNIT 1: HISTORICAL BACKGROUND TO INTERNATIONAL ACCOUNTING

UNIT 2: THE CONCEPTS OF INTERNATIONAL AND UNIVERSAL ACCOUNTING

UNIT 3: INTERNATIONAL HARMONIZATION OF ACCOUNTING STANDARDS

MODULE 2: INTERNATIONAL ACCOUNTING STANDARDS AND ORGANIZATIONS

UNIT 1: INTERNATIONAL ACCOUNTING STANDARD SETTING BODIES AND ORGANS

UNIT 2: ADOPTION OF IFRS IN NIGERIA

MODULE 3: ACCOUNTING FOR MULTINATIONAL CORPORATIONS

UNIT 1: THE MULTINATIONAL CORPORATIONS

UNIT 2: PRESENTATION AND ANALYSIS OF FINANCIAL REPORTS BY MULTINATIONAL CORPORATIONS

UNIT 3: PERFORMANCE EVALUATION IN MNCS

MODULE 4: ACCOUNTING FOR FOREIGN OPERATIONS

UNIT 1: IAS 21 AND REPORTING FOREIGN CURRENCY TRANSACTIONS IN THE FUNCTIONAL CURRENCY

UNIT 2: IAS 21 AND FINANCIAL STATEMENT TRANSLATION OF FOREIGN OPERATIONS: FOREIGN BRANCHES

UNIT 3: IAS 21 AND FINANCIAL STATEMENT TRANSLATION OF FOREIGN OPERATIONS: CONSOLIDATED FINANCIAL STATEMENTS

MODULE 1: INTRODUCTION TO INTERNATIONAL ACCOUNTING

UNIT 1: HISTORICAL BACKGROUND TO INTERNATIONAL ACCOUNTING

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 HISTORY OF ACCOUNTING
 - 3.2 CONCEPT OF INTERNATIONAL ACCOUNTING
 - 3.3 FACTORS INFLUENCING INTERNATIONAL ACCOUNTING DEVELOPMENT
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

The concept of accounting has grown over the years, from the time of simple book keeping to the age of globalization. The past of accounting is crucial to understanding its present and determining its future. This unit discusses the various factors influencing accounting development in many countries around the world, as the system of international accounting primarily connotes accounting in different types of environment.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Trace the history of accounting to pre-lucapacioli era*
2. *Discuss the concept of international accounting*
3. *Discuss the factors influencing accounting development globally.*

3.0 MAIN CONTENT

3.1 HISTORY OF ACCOUNTING

The history of accounting and international accounting are intertwined, although accounting begat international accounting. Generally it is believed that accounting history can be traced to Luca Pacioli in 1494, however, the history of accounting dates back to period before the advent of the concept of money which is before Luca Pacioli Era (Jayeoba&Ajibade, 2016). The formal book keeping and accounting process was first documented by Luca Pacioli in 1494. The evidence of accounting's existence before the advent of the concept of money was supported by archaeologists and historians who discovered the oldest city of Jericho as a trade centre for salt. It was evidenced in this city that no complete accounting was there but the artifacts revealed remains of a temple priest taking inventory of the village livestock using tokens to keep track of the herd size and count the grain harvest (Mattessich, 1989). It can be deduced from the fossils and records discovered not only in Jericho but other parts of the world, that before men knew the concept of money, the process of stewardship was known.

Accounting therefore, can be said to be as old as civilization itself, as writing developed over 5,000 years ago and archaeological findings revealed that writing was in fact developed by accountants (Salisu, 2011). Further look into the history, the development of the science of accounting has itself driven the evolution of commerce since it was only through the use of more precise accounting methods that modern business was able to grow, flourish and respond to the needs of its owners and the public (John, 2002).

However, in the year 1494, Luca Pacioli published *Summa de Arithmetica, Geometrica, ProportionietProportionalite* which was a summary of existing mathematical knowledge of the time and contained a section on "Details of Accounting and Recording" that described bookkeeping as used in Venice. Pacioli's *Summa* was the first complete description of double entry bookkeeping (Geijsbeek, 1914). The double entry bookkeeping was referred to as a memorandum book, journal, and ledger were required, with the journal and ledger similar to modern equivalents. A trial balance was used when the books were closed. The profit or loss was entered into the capital account to balance the balance sheet (Lemarchand, 1999). This further gave rise to the dawn of modern accounting practices where professional bodies were formed, accounting standard setters were established. These were established to ensure

uniformity, understand-ability, and transparency of financial reports and accounts prepared by accountants and ensure their compliance.

3.2 CONCEPT OF INTERNATIONAL ACCOUNTING

Historically, accounting and reporting grew up largely independently, and often very differently, on different countries. Practice, regulation and indeed, the mode and volume of regulation, differed, often very greatly. With the global economy, instant communication and a global finance market, this situation has changed sharply and this process of change is continuing (Peragallo, 1938). The developments in various economies of the world paved ways for cross border trading and foreign direct investments. As such, local preparers of financial statements have the mindset that their reports are been used globally. Thus, globalization brought about international accounting.

International accounting as a concept can be defined as the process of identifying, collecting, recording, measuring, classifying, verifying, summarizing, interpreting and communicating financial information to various users globally for meaningful financial decision making. The use of the financial statements globally separate international accounting from domestic accounting. The system of international accounting primarily connotes accounting in different types of environment.

3.3 FACTORS INFLUENCING INTERNATIONAL ACCOUNTING DEVELOPMENT

Just as nations differ in their histories, values and political systems, they also have different patterns of financial accounting development. Basically, this environment is expressed by shaping factors that influence the development of accounting. Therefore, it is in the light of this to discuss further those factors that influence accounting development.

1: External Finance

The source of finance to organizations differ in various countries and this influence their accounting profession. In situation where a company grows from private ownership to public ownership due to the need for capital increase, the first observation is that the shareholder group becomes large and diverse. The second observation is that ownership is separated from management. Owners of the business (shareholders) become essentially uninvolved in the

day-to-day management of the companies they owned. In such situation, in order to know how well a company is doing, financial accounting information becomes an important source of information. This was how the industrial revolution in the United States and Britain aided the development of accounting.

Another point in external financing is the credit system. Where banks are primarily the source of capital, financial accounting is oriented toward creditor protection. There are close ties between companies and banks. The information needs of the resource providers are satisfied in a relatively straightforward way through personal contacts and direct visits. Since the business enterprises have to deal with only a few creditors and sometimes even one, direct access in an efficient and practical way to have the company's financial health monitored. Another consideration in external financing is to what extent the government gets involved in company investment. Like in France and Sweden where the National Governments play a strong role in managing their resources and business enterprises are expected to accomplish the governments' policies and macro-economic plans. Governments also actively ensure that businesses have adequate capital and will lend or even invest in companies if necessary. Financial accounting is oriented toward decision making by government planners. Firms follow uniform accounting procedures and reporting practices, which facilitate better government decisions.

Finally, the relationship between a company and provider of capital changes when new capital is secured from international financial markets means that the information demands of both domestic and international sources of finance must be satisfied. This would call for going beyond domestic expectations and customs in providing financial reports.

2. Legal System

A major factor that influences the development of accounting is the legal system that operates in that country. Many dissect the accounting world into those countries with a 'legalistic' orientation toward accounting and those with a 'non legalistic' orientation. They explained that the legalistic approach to accounting is predominantly represented by the so called code law countries while the non-legalistic approach is the so-called common law countries.

Laws in code law countries stipulate the minimum standard of behaviour expected. Citizens are obligated to comply with the letter of the law. In most code law countries, accounting

principles are codified much as the tax code is in the United States. Thus, financial accounting is administered by government bodies. Accounting practices and rules tend to be highly prescriptive, detailed and procedural. A primary role of financial accounting in these countries is to determine how much income tax a company owes the government. For example, such countries are Argentina, France and Germany.

The non-legalistic approach found in common law countries establishes the limits beyond which it is illegal to venture. However, within this limits, latitude and judgment are permitted and encouraged. Accounting practices in common law countries are largely determined by accountants in the private sector and they evolve by becoming commonly accepted in practice. Thus, accounting tends to be more adaptive and innovative. Examples of common law countries that adopt non-legalistic approach are the United States and the United Kingdom.

3. Political and Economic ties with other Countries

One factor that has shaped accounting development is the political and economic ties that exist among nations. The United States has influenced accounting in Canada due to geographic proximity and friendly economic ties and because a number of Canadian companies routinely sell shares of common stock or borrow money in the United States. The United States is Mexico's principal trading partner: and also because of proximity, accounting in Mexico is very much like that in the United States.

Another significant force in international accounting has been the United Kingdom. Almost every former British colony has an accounting profession and financial accounting practices patterned after the UK model. These countries include Australia, New Zealand, Malaysia, Pakistan, India, South Africa and Nigeria. The British did not only export their brand of accounting but also exported many accountants. Most early US accountants also came from Britain, seeking the job opportunities associated with the economic expansion that was occurring in the United States around the turn of the 20th century.

The political and economic ties among nations have forced accounting practices to become more similar. Consequently, this has led to the rise of the International Accounting Standards Committee (IASC) which has become the driving force globally to develop international financial accounting standards and sought for their widest possible acceptance and use. Similarly, the International Federation of Accountants Committee (IFAC), among many

other activities, develops and issues international auditing standards which were accepted in 1992 for financial reporting in international financial market.

4. Level of Inflation

Another factor that influences the development of accounting development is the level of inflation. Accounting in many countries is based on the historical cost principle. The principle is based on an assumption that the currency unit used to report financial results is reasonably stable. The historical cost principle holds that the recording of transactions at prices when they occur should be done and there should not be changes in the prices at later date. Generally, historical cost principle affects accounting most significantly in the area of assets values that the company keeps for a long time such as land and buildings. The reasonableness of the historical cost principle varies inversely with the level of inflation.

Germany and Japan hold strictly to historical cost principle because they have historically experienced very little inflation. However, some South American countries, ravaged by inflation problem for years, long ago abandoned any attachment to strict historical cost. Companies in these countries routinely write up the values of their assets based on changes in general price levels.

5. Size and Complexity of Organizations

The size and complexity of businesses in a country determine the country's accounting sophistication. Larger and more complex business enterprises have more difficult accounting problems. Highly trained accountant are needed to handle these more difficult problems, accounting cannot be highly developed in a country where general education levels are low, unless that country imports accounting talent or sends bright citizens elsewhere for the necessary training. At the same time, the users of a company's financial reports must themselves be sophisticated- or else there will be no demand for sophisticated accounting reports.

Most multinational corporations are headquartered in the wealthy, industrialized nations (e.g Japan, Germany, Great Britain and the United States). These countries have sophisticated accounting systems and highly qualified professional accountants. In contrast, education levels in most developing countries are low and businesses are small. As a result, accounting is primitive. From earlier discussion however, it may occur to you that if accounting responds

to information needs, then accounting in developing countries may very well be at an appropriate level of sophistication under the circumstances. While many accountants hold this view, some feel that the lack of sophisticated accounting ability in less developed countries actually impedes their potential for economic progress.

4.0 CONCLUSION

The evolution of accounting has been traced to a period before civilization, from the singular purpose of rendering reports to the owners of the business in the same environment to more complicated purposes. The concept of international accounting becomes important where accounting reports are used by diverse users in various countries. Diverse users in various countries consequently have an impact on the development of their respective accounting standards and rules. This is due to the fact that accounting development is very much a function of external finance, legal system, political and economic ties with other countries, and levels of inflation, size and complexity of organizations in the country in which the accounting system exists. The objectives of the accounting system are often linked from an historical perspective to goals and objectives of the perceived users of the financial statements.

5.0 SUMMARY

In this unit, the history of accounting was traced to the period pre-luapacioli era. Further emphases were placed on distinguishing domestic accounting from international accounting. Subsequently, various factors influencing accounting development globally were discussed.

6.0 TUTOR-MARKED ASSIGNMENT

1. Distinguish between the concept of accounting and international accounting
2. Trace the history of accounting with emphasis on periods before and after Luca Pacioli.
3. List and explain five factors influencing accounting development globally.

7.0 REFERENCES/FURTHER READINGS

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UNIT 2: THE CONCEPTS OF INTERNATIONAL AND UNIVERSAL ACCOUNTING

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 ORIGIN OF NATIONAL DIFFERENCES IN ACCOUNTING
 - 3.2 CAUSES OF INTERNATIONAL ACCOUNTING DIFFERENCES
 - 3.3 SOME EXISTING ACCOUNTING PRACTICE DIFFERENCES
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READING**

1.0 INTRODUCTION

Owners of companies in the past engage in managing their companies, gradually ownership was separated from management and this evolution led to the development of external reporting. The previous unit provided a platform as to the meaning of accounting and major factors that influence its development. This unit exposes the students to the origin of national differences in accounting, the causes of these differences, and some existing practices in accounting.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

- 1. Discuss the origin of national differences in accounting*
- 2. Explain the various causes of international accounting differences*

3. *Highlight some of the existing practice differences in accounting*

3.0 MAIN CONTENT

3.1 ORIGIN OF NATIONAL DIFFERENCES IN ACCOUNTING

The evolution of financial reporting from internal reporting to external reporting can be traced to the separation of the roles of owners and managers of the business. Early financial reports can hardly be called external; they were a means by which the owners could get an insight into their income and capital. The company was apart of and managed by its owners. One could hardly distinguish between internal and external financial reports. From early 1800s on, the increasing scale of companies resulted in finance problems and the need for a disconnection of management and capital supply, private capital alone was insufficient to finance business activities, so capital was gathered from people outside the company.

The separation of ownership and management makes it possible to have the company managed by people specializing in management. The owners delegate control and the evaluation of the management to the board of directors. As such, financial reports evolved from internal to external reporting, but for a long time external reporting meant providing information within the borders of a specific country. Thus, because national authorities perceive that there are alternatives for recognition and measurement and presentation they have chosen those recognition, measurement, consolidation and presentation policies which best fitted their national environments. The annual report, for example, provides information on the financial position of a company and its results. Although the general purpose is similar in most countries, many differences occur resulting from different environmental and cultural influences in the individual countries.

3.2 CAUSES OF INTERNATIONAL ACCOUNTING DIFFERENCES

The likely causes of the differences in financial reporting internationally are discussed here according to Nobes and Parker (2003):

1. Culture: Cultural differences between nations are identified as an important influencing factor on reporting and disclosure behaviour with regard to financial statements e.g. secrecy versus transparency, uniformity versus flexibility. Accounting is affected by its environment, including the culture of the country in which it

operates. One of the prominent researchers on cultural differences is Hofstede (1980). Gray (1988) applies these cultural differences to explain international differences in the behaviour of accountants and therefore in the nature of accounting practices. For example, Gray suggests that a country with high uncertainty avoidance and low individualism will be more likely to exhibit conservative measurement of income and a preference to limit disclosure to those closely involved in the business. Hofstede (1980) developed a model of culture as '*the collective programming of the mind that distinguishes the members of one human group from another*'. Hofstede (1984) defined the following four constructs to classify countries according to the cultural differences he observed in his empirical research:

- Individualism versus collectivism: Individualism stands for a preference for a loosely knit social framework in society wherein individuals are supposed to take care of themselves and their immediate families only. The fundamental issue addressed by this dimension is the degree of interdependence that a society maintains among individuals. This influences the choice of accounting system of secrecy versus transparency in disclosure requirements.
- Large versus small power distance: Power distance is the extent to which the members of a society accept that power in institutions and organizations is distributed unequally. People in societies that have large power distance accept a hierarchical order in which everybody has a place which needs no further justification. The fundamental issue addressed by this dimension is how society handles inequalities among people when they occur. This is linked to the choice of the developers of accounting standards between professional bodies and statutory regulators.
- Strong versus weak uncertainty avoidance: Uncertainty avoidance is the degree to which the members of a society feel uncomfortable with uncertainty and ambiguity. This feeling leads them to beliefs promising certainty and to maintain institutions protecting conformity. Strong uncertainty avoidance societies maintain rigid codes of belief and behaviour and are intolerant towards deviant persons and ideas. Weak uncertainty avoidance societies maintain a more relaxed atmosphere in which practice counts more than principles and deviance is more easily tolerated. A fundamental issue addressed by this dimension is how a society reacts to the fact that time runs only one way and that the future is unknown: whether it tries to control the future or

lets it happen. This influence the disclosure practices in the accounting system and the choice between conservatism and optimism.

- Masculinity versus femininity: Masculinity stands for a preference in society for achievement, heroism, assertiveness (boldness) and material success. Its opposite, femininity, stands for a preference for relationships, modesty, caring for the weak, and the quality of life. This affects the degree of uniformity and flexibility of the accounting system in a society.
2. Legal System: Some countries have a legal system that relies upon a limited amount of statute law, which is then interpreted by courts, which build up large amounts of case law to supplement the statutes. In the past two types of legal systems have developed in the West:
- The common law system: The common law system originated in England, primarily after the Norman Conquest, by judges acting on the king's behalf. Common law is characterized as a legal system which develops case by case and which does not prescribe general rules, which could be applied to all cases. In common law countries accounting regulation is in the hands of professional organizations in the private sector. Company law is kept to a minimum and detailed regulation is produced by the private standard setter. Although this common law system emanates from England, it may be found in similar forms in many countries influenced by England. Thus, the federal law of the United States, the laws of Ireland, India, Australia, Nigeria and so on, are to a greater or lesser extent modeled on English common law. There seems to be an association of common law countries with particular types of accounting practices.
 - The code law system. The code law system originated in Roman law and has developed in continental Europe. It is characterized by a wide set of rules which attempt to give guidance in all situations. In the code law countries the company law is very detailed and accounting standards are often embodied in the company law. Accounting regulation in code law countries is in the hands of the government and financial reporting is in those circumstances often reduced to complying with a set of very detailed legal rules.
3. Providers of Finance (Source of Finance): The difference in providers of finance (creditors/insiders) versus (equity/owners/outside) is the key cause for international

differences in financial reporting (Nobes & Parker, 2003). Companies in different countries respond differently to the increased need for finance. In Germany, France, Italy, Belgium, banks became the major supplier of additional funds. Thus companies relied more on debt financing. On the contrary, in the UK and in the US shareholders provided extra funds. This has given rise to active stock exchanges.

In most continental European countries and in Japan, the traditional paucity of 'outsider' shareholders has meant that external financial reporting has been largely invented for the purposes of protecting creditors and for governments, as tax collectors or controllers of the economy. This has not encouraged the development of flexibility, judgment, fairness or experimentation. However, it does lead to precision, uniformity and stability. It also seems likely that the greater importance of creditors in these countries leads to more careful (prudent, conservative) accounting. This is because creditors are interested in whether, in the worst case, they are likely to get their money back, whereas shareholders may be interested in an unbiased estimate of future prospects.

4. **Taxation:** In some countries fiscal authorities use information provided in the financial statements to determine taxable income. In some countries the costs are only tax deductible if they are also recognized in the profit and loss account. This may lead to the danger, that financial reporting becomes tax influenced or even tax biased. In the UK and Nigeria the link between taxes and accounting is much weaker. Separate accounts are filed for tax purposes.

3.3 SOME EXISTING ACCOUNTING PRACTICE DIFFERENCES

- **Conservatism and accruals:** The word 'conservatism' in the accounting literature has two different meanings. It is explained as the tendency to understate profit and assets. This is associated with the state's desire to limit dividends in order to protect creditors, and with a company's desire to limit taxable income. It is also the speed with which losses are reported. Perhaps because of the different mix of users in differing countries, conservatism (in the former sense) is of different strengths. For example, the importance of banks in Germany may be a reason for greater conservatism in reporting. It is widely held that bankers are more interested in 'rock-bottom' figures in order to satisfy themselves that long-term loans are safe. At the same time, the consequent lack of interest in a 'fair' view reduces the need to modify

conservatism. IFRS refers to the concept of 'prudence' rather than 'conservatism'. In many cases, accounting standards are the compromise treaties that settle a battle between prudence and the accruals concept.

- Provisions and reserves: The area of 'provisions' and 'reserves' is fraught with linguistic difficulties. For example, in American English the word 'reserve' always means 'provision' in UK English. UK English will be used here, but this still leaves another difficulty in that the word 'provision' means two things: (i) a liability of uncertain timing or amount (e.g. 'provision for pensions') and (ii) an allowance against (or impairment of) the value of an asset (e.g. 'bad debt provision' or 'provision for depreciation'). The IFRS usage is 'provision' to mean the first of these, and 'impairment' to mean the second. Setting up a provision or making impairment involves a charge against income, but there is an important distinction. Making impairment is a matter of measurement relating to an asset which has already been recognized. By contrast, setting up a provision requires three stages of consideration: is there a liability? Should it be recognized? How should it be measured? The distinction between provisions and reserves is important for financial reporting because provisions are liabilities recognized by charges against profit, whereas reserves are elements of equity caused by undistributed gains.
- Measurement of assets: There is great international variation in the degree to which departures from a cost basis are allowed or required. In a country with detailed legal rules and a coincidence of tax and commercial accounting the predominant valuation system will involve as little judgment as possible. Flexibility and judgment would make it difficult for auditors to determine whether the law had been obeyed and might lead to arbitrary taxation demands. Now IFRS and UK rules allow revaluation of tangible and some intangible assets, as long as it is continuous and applies to all assets of the same sort.
- Financial statement formats: Balance sheets vary in two main ways under domestic rules. First, in some countries, assets are displayed in order of decreasing liquidity (cash first), whereas in other countries there is an increasing order of liquidity (intangible fixed assets come first). The key to predicting is that the decreasing order is used by countries influenced by the United States, and the increasing order is used by countries in the EU. The other main variation in balance sheets is the shape of

them. Some combine together all the debits and then all the credits. Such balance sheets are either two-sided (with assets on the left) or in 'report form' on a single page (with assets at the top). Other companies arrange the items in order to calculate totals of net current assets and net assets; this may be called a 'financial position format'. These three shapes (with assets in order of increasing liquidity) are all allowed in the EU. There is no US requirement on the shape of balance sheets. For income statements, the variety is rather more of a problem for users of financial statements.

4.0 CONCLUSION

Although there is a universal purpose of financial reporting, there exists diversity in reporting processes. Accounting practices all over the world are influenced by national environmental factors and conditions as discussed in this unit. However, when accounting practices between countries are far apart there will be problems of understandability of these reports. As such, the focus of global harmonization of accounting practices.

5.0 SUMMARY

In this unit, we discussed the concept of international and universal accounting under the following sub-units: origin of national differences in accounting, the causes of these differences, and some existing practices in accounting.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the origin of national differences in accounting
2. List and explain five causes of international accounting practices
3. What does conservatism and accruals imply in accounting?

7.0 REFERENCES/FURTHER READINGS

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UNIT 3: INTERNATIONAL HARMONIZATION OF ACCOUNTING STANDARDS

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 NATURE OF HARMONIZATION OF ACCOUNTING STANDARDS
 - 3.2 REASONS FOR HARMONIZATION OF ACCOUNTING STANDARDS
 - 3.3 OBSTACLES FOR HARMONIZATION OF ACCOUNTING STANDARDS
 - 3.4 MEASUREMENT OF HARMONIZATION OF ACCOUNTING STANDARDS
 - 3.5 ROLE OF IASB AND OTHER BODIES IN ACCOUNTING STANDARDS HARMONIZATION
 - 3.6 POLITICAL LOBBYING ON ACCOUNTING STANDARDS
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

To bridge the gap of diversity in accounting practices as discussed in the previous unit, the project to harmonize accounting practice was set up by the International Accounting Standards' Board (IASB) through the implementation of International Financial Reporting Standards (IFRS). This unit discusses the nature, reasons, obstacles and measurement of harmonization of accounting standards; the role of IASB and other bodies in the harmonization; and Political lobbying on accounting standards.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Discuss the reasons for harmonization of accounting standards*
2. *Highlight the obstacles for harmonization of accounting standards*
3. *Discuss the measurement of harmonization of accounting standards*
4. *Explain the roles of IASB and other bodies in the harmonization of accounting standards*
5. *Explain the concept of political lobbying on accounting standards.*

3.0 MAIN CONTENT

3.1 NATURE OF HARMONIZATION OF ACCOUNTING STANDARDS

Harmonization simply implies uniformity. As a result of the existing diversity in financial reporting styles all over the world, harmonization of accounting standards become important. This harmonization is tailored towards breaking the barriers of national differences so that financial reports prepared across the globe can be easily comparable, understandable, and relevant for economic decision making. Nobes and Parker (2008) explained that ‘Harmonization’ is a process of increasing the compatibility of accounting practices by setting bounds to their degree of variation. Thus, harmonization of accounting standards implies the development of accounting standards to be used across the globe to promote uniformity and quality financial reporting.

3.2 REASONS FOR HARMONIZATION OF ACCOUNTING STANDARDS

The resulting effect of use of various accounting practices all of over the world otherwise called consequences are the reasons for the harmonization of accounting standards. These are discussed below:

1. **Corporate management of Multi-national Corporations:** the managers of MNCs face global competition and crave for uniformity in accounting practices. Not only to reduce the cost of re-preparing subsidiaries’ financial statements but also to enhance ease of comparability. Thus, a major reason for harmonization of accounting standards is higher cost involved in re-preparing subsidiaries financial statements by the MNCs.

2. Investors: financial analysts and investors experience difficulties with accounting diversity due to information asymmetry and lack of uniformity. Foreign investors crave to understand and compare financial reports from different countries.
3. Stock market and regulators: To protect investors, most stock markets require listed companies to disclose sufficient information so that investors can assess their past performance and future prospect. Market quality is achieved by fair and efficient trading and by the availability of investment opportunities for market participants. Stock markets and regulators interpret these goals differently around the world. For example, accounting and disclosure requirements for listing shares vary extensively. Research shows that MNCs consider these requirements to be an important cost when they choose where to list their common stock shares. Indeed, MNCs are less likely to choose stock exchanges that require them to make extensive new disclosures over and above those that they are already making at home.
4. Accounting Professionals and Standard Setters: Some have suggested that accounting professionals like diversity because it generates fees for them all the way from assisting in setting up new business units for their clients in different GAAP territories to restating financial reports from one set of GAAP to another. GAAP diversity also makes cross-border auditing more costly and therefore raises auditing fees. Although, another school of thought argues that when there is diversity, accounting professionals are expected to train and re-train staff when dealing with foreign clients. This leads to additional cost on the part of the client and the accounting professional.
5. Analysis and Comparison: Differences in the treatment of the same type of transactions' makes it difficult to analyze and compare financial statements among the countries.
6. Reliability: National accounting standards especially in emerging economies are often seen to be less reliable and low in quality since they are not generally acceptable across countries. Implying that, harmonization of accounting standards will lead to more reliable financial reports.

3.3 OBSTACLES FOR HARMONIZATION OF ACCOUNTING STANDARDS

The following are the obstacles of accounting standards' harmonization:

1. Size of the national differences: it has been identified earlier that there exist differences in the accounting practices of different countries, the size of these differences mitigate the harmonization of accounting standards.
2. Lack of international regulatory agency: the regulatory agency assist in ensuring the compliance of accounting standards, however there is no international regulatory agency to ensure the compliance of countries to harmonized accounting standards.
3. Unwillingness of countries: Due to peculiar national differences, some countries may not want to lose their sovereignty by accepting compromises that involve changing accounting practices towards those of other countries.
4. Lack of expertise: lack of technical know-how on the part of accounting professional in accepting different accounting practice.

3.4 MEASUREMENT OF HARMONIZATION OF ACCOUNTING STANDARDS

In order to measure the level of accounting standards' harmonization, the comparability levels of the published financial reports are determined. The comparability index is used to determine areas of uniformity of accounting treatment of various financial reports from different countries.

3.5 ROLE OF IASB AND OTHER BODIES IN ACCOUNTING STANDARDS HARMONIZATION

The most successful body involved in harmonization has been the International Accounting Standards Committee (IASC) and its successor, the International Accounting Standards Board (IASB). The International Accounting Standards' Board (IASB) through the implementation of International Financial Reporting Standards (IFRS) has encouraged accounting standards harmonization. Another professional body that has played significant role in the harmonization of accounting standards is the International Federation of Accountants (IFAC). The history and roles of IASC, IASB and IFAC will be discussed in the next module.

The governmental bodies concerned with harmonization of accounting standards around the world are: United Nations (UN), (OECD), and (IOSCO).

3.6 POLITICAL LOBBYING ON ACCOUNTING STANDARDS

Accounting standard-setters such as the International Accounting Standards Board (IASB) are often challenged with the issue of political lobbying driven by preparer or governmental self-interest. This is done by those who have vested interest in certain treatments of transactions mount pressure on the standard-setter not to approve the standard containing an objectionable feature. This usually includes: lobbying, writing letters, giving oral testimony at a hearing arranged by a standard-setter to expose its tentative views to public comment. It is usually a complaint against a specific standard in its proposal states. This is the reason for stalling some standards on certain issues. Issues such as share-based payment, pensions, insurance, leases and performance reporting have caused controversy in the past. This may cause the standard-setters to modify their positions and run the risk of diluting or abandoning the principles implicit in their standards (Nobes & Parker, 2009). The likelihood of political lobbying would increase in some countries if the proposed standard were either to lower companies' earnings or make their trend of earnings.

4.0 CONCLUSION

Although there is a universal purpose of financial reporting, there exists diversity in reporting processes. Accounting practices all over the world are influenced by national environmental factors and conditions as discussed in this unit. However, when accounting practices between countries are far apart there will be problems of understandability of these reports. As such, the focus of global harmonization of accounting practices.

5.0 SUMMARY

In this unit, we discussed the concept of international and universal accounting under the following sub-units: origin of national differences in accounting, the causes of these differences, and some existing practices in accounting.

6.0 TUTOR-MARKED ASSIGNMENT

1. Explain the origin of national differences in accounting
2. List and explain five causes of international accounting practices
3. What does conservatism and accruals imply in accounting?

7.0 REFERENCES/FURTHER READINGS

Nobes, C. & Parker, R. (2008). *Comparative international accounting*. 10th Edition. UK: Prentice Hall.

MODULE 2:INTERNATIONAL ACCOUNTINGSTANDARDS AND ORGANIZATIONS

UNIT 1: INTERNATIONAL ACCOUNTING STANDARD SETTING BODIES AND ORGANS

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 ABBREVIATIONS IN ACCOUNTING STANDARDS
 - 3.2 INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC) AND AFFILIATES
 - 3.3 FINANCIAL ACCOUNTING STANDARD BOARD (FASB) OF U.S.A
 - 3.4 INTERNATIONAL FINANCIAL REPORTING STANDARD FOUNDATION (IFRS FOUNDATION) AND AFFILIATES INCLUDING IASB
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

This unit discusses the major international accounting setting bodies in the world. There are two main international accounting setting bodies; these are the IASB and the FASB. While the IASB sets accounting standards that are globally acceptable, the FASB sets accounting standards for the United States. Thus, the IASB and FASB are discussed and the IFAC is also discussed here.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Explain certain abbreviations in accounting standards*
2. *Discuss the origin of FASB*
3. *Discuss the functions of IFAC*
4. *Highlight the purposes of IFRS foundation*

3.0 MAIN CONTENT

3.1 ABBREVIATIONS IN ACCOUNTING STANDARDS

Certain abbreviations are used in the discussion of accounting standards, some of this include:

1. IAS: International Accounting Standards
2. IASC: International Accounting Standards Committee
3. IASB: International Accounting Standards Board
4. IFRS: International Financial Reporting Standards
5. SAS: Statement of Accounting Standards
6. NASB: Nigerian Accounting Standards Board
7. FRCN: Financial Reporting Council of Nigeria
8. IFAC: International Federation of Accountants
9. FASB: Financial Accounting Standards Board

3.2 INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC).AND AFFILIATES

The International Federation of Accountants (IFAC) is the global organization for the accountancy profession dedicated to serving the public interest by strengthening the profession and contributing to the development of strong international economies. IFAC is comprised of over 175 members and associates in more than 130 countries and jurisdictions, representing almost 3 million accountants in public practice, education, government service, industry, and commerce. Their members and associates are representatives from various professional accountancy bodies from different countries including developing, emerging, and developed countries. IFAC was established in 1977 and perform the following roles:

1. Provides the structures and processes that support the development of high-quality international standards;

2. The standards it supports, in the areas of auditing, assurance, and quality control; public sector accounting; accounting education; and ethics, are an important part of the global financial infrastructure and contribute to economic stability around the world;
3. Through its member bodies, IFAC provides tools and guidance to facilitate the adoption and support implementation of standards and support professional accountants in business and small and medium practices;
4. Supports the development of the accountancy profession in emerging economies;
5. Speaks out on public interest issues where the profession's voice is most relevant; and
6. Promotes its values of integrity, transparency, and expertise

3.3 FINANCIAL ACCOUNTING STANDARD BOARD (FASB) OF U.S.A

The Financial Accounting Standards Board (FASB) is the primary standard setting body in the United States. It is a private organization that is non-profit making with the main responsibility of establishing and improving already established accounting standards with the US. The FASB was established in 1973 to replace the American Institute of Certified Public Accountants' (AICPA) Accounting Principles Board (APB). The Securities and Exchange Commission (SEC) saddled the FASB with the responsibility of setting accounting standards for public companies in the U.S. The FASB and its predecessor organizations have been issuing accounting standards in the United States since the 1930s (Robinson, Hennie, Elaine, & Michael, 2009).

3.4 INTERNATIONAL FINANCIAL REPORTING STANDARD FOUNDATION (IFRS FOUNDATION) AND AFFILIATES INCLUDING IASB

The International Accounting Standards Committee (IASC) was formed in the year 1973 and was the first international standards-setting body. In 2001, the IASC was reorganized into the International Accounting Standards Board (IASB). The IASB is the independent standard-setting body of the International Financial Reporting Standards (IFRS) foundation. While the IASC formulated the International Accounting Standards (IAS), IASB formulates IFRS and enforces IASs that the substitutes are not yet available in IFRS. This implies that both IAS and IFRS are still relevant under the IASB. The IFRS foundation is an independent private organization that is non-profit making working in the public interest and charged with the following objectives according to Olanrewaju (2012):

1. To develop a single set of high quality, understandable, enforceable and globally accepted IFRSs through its standard setting body, IASB;
2. To promote the use and rigorous application of those standards;
3. To take account of the financial reporting needs of emerging economies and SMEs;
and
4. To bring about convergence of national accounting standards and IFRSs to high quality solutions.

The IASB is responsible for developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards (IFRSs) that require transparent and comparable information in general purpose financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions. The IASB objective is to require like transactions and events to be accounted for and reported in like way and unlike transactions and events to be accounted for and reported differently, both within an entity over time and among entities throughout the world. The choices in accounting treatment are continuously being reduced. Consequently, the IASB has, since its inception, issued a number of IFRSs and interpretations, and amended several IASs including interpretations issued under the previous Constitutions of IASC. In pursuit of its objectives, the IASB cooperates with national accounting standards setters to achieve convergence in accounting standards around the world.

IFRSs are developed through an international due process that involves accountants, financial analysts and other users of financial statements, the business community, Stock Exchanges, regulatory and legal authorities, academics and other interested individuals and organizations from around the world. This due process is conducted by the IASB, which has complete responsibility for all technical matters including the publication and issuing of standards and interpretations (Josiah, Okoye, & Adediran, 2013). The IFRSs were first adopted in 2005 by many countries and as at 2017; over 100 countries around the world have adopted IFRS including Nigeria.

4.0 CONCLUSION

The IFAC acts as a check on both the accounting profession and the standard providers. Although, the FASB still formulates standards for the US, the IFRS have since been adopted by more than 100 countries around the world. By adopting IFRS, countries including Nigeria

are assured of comparable financial reports.

5.0 SUMMARY

This unit explained the key terms used in accounting standards globally; gave background information of IFAC, FASB and IFRS foundation.

6.0 TUTOR-MARKED ASSIGNMENT

1. What is the full meaning of FASB?
2. Explain the roles of IFAC.
3. What are the functions of IFRS foundation?

7.0 REFERENCES/FURTHER READINGS

Josiah, M., Okoye, A. E., & Adediran, O. S. (2013). Accounting standards in Nigeria, the journey so far. *Research Journal of Business Management and Accounting*, 2(1), 001-010

Olanrewaju, O. O. (2012). *IFRS pal – handy approach*. Lagos; Dimkem Publications Limited.

Robinson, T. R., Hennie, V. G., Elaine, H., & Michael, A. B. (2009). Financial reporting standards: International financial statement analysis. *CFA Institute Investment Series*

UNIT 2: INTERNATIONAL FINANCIAL REPORTING STANDARDS

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 ABBREVIATIONS IN ACCOUNTING STANDARDS
 - 3.2 INTERNATIONAL FEDERATION OF ACCOUNTANTS (IFAC) AND AFFILIATES
 - 3.3 FINANCIAL ACCOUNTING STANDARD BOARD (FASB) OF U.S.A
 - 3.4 INTERNATIONAL FINANCIAL REPORTING STANDARD FOUNDATION (IFRS FOUNDATION) AND AFFILIATES INCLUDING IASB
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

Globally, the IFRS is gradually gaining acceptability. As discussed in the previous section, the need to speak a uniform accounting language led to the development of IFRSs. Thus, this section discusses the IFRS and IAS, the IFRS interpretation committee and gave an highlight of available IAS and IFRS.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Differentiate between IAS and IFRS*
2. *Discuss the origin of IAS*

3. *Highlight the structure of IASB*
4. *Explain the functions of IFRS interpretation committee*

3.0 MAIN CONTENT

3.1 INTERNATIONAL FINANCIAL REPORTING STANDARDS

The term IFRS consists of IFRS issued by International Accounting Standards Board (IASB); International Accounting Standard (IAS) issued by International Accounting Standard Committee (IASC); and interpretations issued by the standard interpretations Committee (SIC) and the International Financial Reporting Interpretation Committee (IFRIC). The International Accounting Standard states how particular types of transactions and other events should be reported in financial statements. The standards issued by IASC were known as IAS. In 2000, IASC member bodies approved the restructuring of IASC's foundation and in March 2001, the new IASB took over the responsibility of setting the international Accounting Standards from IASC. IASB adopted the standards set by IASC and continued to develop new standards and called the new standards – IFRS. Both IFRS and IAS are equally enforceable because there is no difference between the two (Ikpefan&Akande, 2012).

The predecessor of the IASB, the International Accounting Standards Committee (IASC), was founded in June 1973. Its creation was related to that of the International Federation of Accountants (IFAC), which is the worldwide umbrella organization of accountancy bodies. It was independent of government or pseudo-government control. By 1998, the IASC had expanded membership to 140 accountancy bodies in 101 countries. The application of IAS in preparing financial statements did not always result into uniform and comparable financial information simply because similar transactions and events were not necessarily reported in a like way. With the dawn of globalization and increasing demand for transparent, comparable financial information in the markets, and in order to become a world leader in standard setting, it was necessary to change the structure of the IASC at the turn of the century, therefore in 2001, the International Accounting Standard Board (IASB) replaced IASC. The IASB formulates IFRSs and further enforce the compliance of IAS that does not have IFRS equivalent. As discussed in the previous unit, IFRS has been adopted by over 100 countries around the globe, Nigeria inclusive.

A total number of 13 IFRSs are in issue as at 2017 and about 31 IASs are still in issue. Its important to note that an IAS become obsolete once there is an equivalent IFRS in issue.

3.2 THE IFRS INTERPRETATIONS COMMITTEE

The interpretative body of the IFRS foundation earlier discussed is the IFRS interpretations committee (IFRIC) formally known as Standing Interpretations Committee (SIC). They are saddled with the responsibility of reviewing on a timely basis widespread accounting issues that have arisen within the contexts of IFRS and IAS. It provides appropriate guide on accounting issues and reaches consensus on the appropriate treatment for these issues. This committee comprises of 14 voting members drawn from a variety of countries and professional backgrounds, they are appointed by the Trustees of the IFRS foundation and are selected for their ability to maintain an awareness of current issues as they arise and the technical ability to resolve them (Olanrewaju, 2012). These interpretations have the same authority as a standard issued by the IASB. A total of 19 IFRIC has been issued as at 2017.

4.0 CONCLUSION

In the quest for high quality financial reports, IFRS was formulated as a high quality accounting standards to promote uniform financial reporting across the globe. The IFRSs consist of IFRS by IASB, IAS issued by IASB, and IFRIC.

5.0 SUMMARY

This unit explained into details the origin of IFRS and SAS; gave background information of IFRIC.

6.0 TUTOR-MARKED ASSIGNMENT

1. Differentiate between IAS and IFRS
2. Highlight the structure of IASB
3. Explain the roles of IFRIC.

7.0 REFERENCES/FURTHER READINGS

Ikpefan, O. A., & Akande, A. O. (2012). International Financial Reporting Standard (IFRS): Benefits, obstacles and intrigues for implementation in Nigeria. *Research Journal of Finance and Accounting* ISSN 2222-1697 (Paper) ISSN 2222-2847 (Online) Vol 3, No 10, 143-151

Olanrewaju, O. O. (2012). *IFRS pal – handy approach*. Lagos; Dimkem Publications

Limited.

UNIT 3: ADOPTION OF IFRS IN NIGERIA

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 HISTORY OF ACCOUNTING STANDARDS IN NIGERIA
 - 3.2 ROLES OF FINANCIAL REPORTING COUNCIL OF NIGERIA
 - 3.3 REASONS FOR THE ADOPTION OF IFRS IN NIGERIA
 - 3.4 CHALLENGES OF IFRS ADOPTION IN NIGERIA
 - 3.5 TAX IMPLICATIONS OF IFRS ADOPTION
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

Accounting standards in general are established first to enhance comparability within a country and outside the country. With the increase in cross border trade and the desire to attract foreign direct investment, Nigeria as a nation adopted IFRS in 2011. This unit discusses the history of accounting standards in Nigeria, reasons for the adoption of IFRS and its challenges.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Discuss the history of accounting standards in Nigeria*
2. *Explain reasons for the adoption IFRS in Nigeria*

3. *Highlight the challenges of adopting IFRS in Nigeria*
4. *Highlight the tax implications of IFRS adoption.*

3.0 MAIN CONTENT

3.1 HISTORY OF ACCOUNTING STANDARDS IN NIGERIA

In some countries, the professional bodies formulate the financial accounting standards, while in many others, governments and regulators establish these standards. In Nigeria, the development of accounting and accounting standards could be traced to the then Association of Accountants of Nigeria - AAN (now Institute of Chartered Accountants of Nigeria - ICAN). The AAN was formed on the 17th of November 1960 and granted official recognition on 28th September 1965, under the Federal Parliament Act number 15 of 1965, to regulate accountancy profession in the country. History suggests that ICAN was responsible for the formation of the Nigerian Accounting Standards Board (NASB) before it was taken over by government (Jayeoba&Ajibade, 2016).

The Nigeria Accounting Standard Board (NASB) was established in 1982 as a private sector initiative closely associated with the Institute of Chartered Accountants of Nigeria (ICAN). NASB first became a government parastatal in 1992 as a component of the then Federal Ministry of Trade and Tourism. The NASB issued a total of 32 Statement of Accounting Standards (SAS). The Nigerian Accounting Standards Board Act of 2003 provided the legal framework under which NASB set accounting standards. Membership includes representatives of government and other interest groups. Both ICAN and the Association of National Accountants of Nigeria (ANAN) nominate two members to the board.

The primary functions as defined in the Act were to develop, publish and update Statements of Accounting Standards (SAS) to be followed by companies in the preparation of their financial statement, and to promote and enforce compliance with the standards. The SASs were seen to be Nigerian modified version of International Accounting Standards (IAS). The IASs were formulated and enforced by International Accounting Standards Committee (IASC).

However, in 2010, it was observed that the NASB did not have adequate funding to achieve its statutory role such as hire new staff, re-train existing staff and offer more attractive pay. In June 2010 Mr. Godson Nnamdi, the then Executive Secretary of Nigeria Accounting

Standards Board, spoke in favour of a new body to set accounting and auditing standards for Nigeria and other African nations that would be independent of both ANAN and ICAN (Egwuatu, 2010).

On June 3, 2011, President GoodluckEbele Jonathan signed into law the Financial Reporting Council of Nigeria Act, No 6, 2011 and therein repealed the Nigerian Accounting Standards Board (NASB) Act No. 22, 2003. The Financial Reporting Council of Nigeria (FRCN) is charged with the responsibility of enforcing the adoption of International Financial Reporting Standards (IFRS).

3.2 ROLES OF FINANCIAL REPORTING COUNCIL OF NIGERIA

The Financial Reporting Council of Nigeria (FRCN) was established by the Financial Reporting Council Act, 2011(Section 1). The Act established for the council a board which shall have overall control of the council. Section 8 of the Act stipulates the functions of the Council as follows:

1. Develop and publish accounting and financial reporting standards to be observed in the preparation of financial statement of public interest entities;
2. Review, promote and enforce compliance with the accounting and financial reporting standards adopted by the Council;
3. Receive notices of non-compliance with approved standards from preparers, users, other third parties or auditors of financial statements;
4. Receive copies of annual reports and financial statements of public interest entities from preparers within 60 days of the approval of the Board;
5. Advise the Federal Government on matters relating to accounting and financial reporting standards;
6. Maintain a register of professional accountants and other professionals engaged in the financial reporting process;
7. Monitor compliance with the reporting requirements specified in the adopted code of corporate governance;
8. Promote compliance with the adopted standards issued by the International Federation of Accountants and International Accounting Standards Board;
9. Monitor and promote education, research and training in the fields of accounting, auditing, financial reporting and corporate governance;

10. Conduct practice reviews of registered professionals;
11. Review financial statements and reports of public interest entities;
12. Enforce compliance with the Act and the rules of the Council on registered professionals and the affected public interest entities;
13. Establish such systems, schemes or engage in any relevant activity, either alone or in conjunction with any other organization or agency, whether local or international, for the discharge of its functions; and
14. Receive copies of all qualified reports together with detailed explanations for such qualifications from auditors of the financial statements within a period of 30 days from the date of such qualification and such reports shall not be announced to the public until all accounting issues relating to the reports are resolved by the Council.

3.3 REASONS FOR THE ADOPTION OF IFRS IN NIGERIA

1. To encourage comparability, reliability, transparency and efficiency of financial reporting in Nigeria.
2. To assure investors abroad of a meaningful decision on portfolio investment.
3. To reduce the cost of doing business abroad by eliminating the need for supplementary information from Nigerian companies.
4. Facilitation or easy consolidation of financial information of the same company with offices in different countries. Multinationals companies avoid the hassle of restating their accounts in local GAAPs to meet the requirements of national stock exchange and regulators, making the consolidation of accounts of foreign subsidiaries easier and lowering overall cost of financial reporting.
5. Easier regulation of financial information of entities in Nigeria.
6. Enhanced knowledge of global financial reporting standards by tertiary institutions in Nigeria.
7. Additional and better quality financial information for shareholders and supervisory authorities.
8. Government to be able to better access the tax liabilities of multinational companies.

3.4 CHALLENGES OF IFRS ADOPTION IN NIGERIA

The practical challenges that have been faced in Nigeria as a result of implementing the IFRS need to be identified and addressed in order to benefit fully from the introduction of IFRS. The challenges according to Obazee (2011) and Fowokan (2011) are discussed as follows:

1. **Accounting Education and Training:** Practical implementation of IFRS requires adequate technical capacity among preparers and users of financial statements, auditors and regulatory authorities. Nigeria faced a variety of capacity-related issues, which was dependent on the approach they took. One of the principal challenges Nigeria encountered in the practical implementation process, was the chronic shortage of accountants and auditors who are technically competent in implementing IFRS. Usually, the time lag between decision date and the actual implementation date is not sufficiently long to train a good number of professionals who could competently apply international standards.
2. **Tax Reporting:** The tax considerations associated with the conversion to IFRS, like other aspects of a conversion, are complex. IFRS conversion calls for a detailed review of tax laws and tax administration. IFRS convergence will create problem. How do taxation laws address the treatment of tax liabilities arising from on convergence from Nigeria GAAP to IFRS. Where this is not taken care of, it would duplicate administrative work for the organization. Specific taxation rules would have to be redefined to accommodate these adjustments. For instance, tax laws which limit relief of tax losses to four years should be reviewed. This is because transition adjustments may result in huge losses that may not be recoverable in four years. Accounting issues that may present significant tax burden on adoption of IFRS, include determination of Impairment, Loan loss provisioning and Investment in Securities/Financial Instruments.
3. **Amendment to Existing Laws:** In Nigeria, accounting practices are governed by the Companies and Allied Matters Act (CAMA) 1990, and the Statement of Accounting Standards (SAS) issued by the Nigerian Accounting Standards Board (NASB) and other existing laws such as Nigerian Stock Exchange Act 1961, Nigerian Deposit Insurance Act 2006, Banks and Other Financial Institution Act 1991, Investment and Securities Act 2007, Companies Income Tax Act 2004, Federal Inland Revenue Services Act 2007. IFRS provisions do not recognize these local laws and if IFRS should be applied fully in Nigeria, the above laws will be modified

4. **Fair Value:** In IFRS format, Fair value is used in measurement of most items of financial statements and this lead to volatility and subjectivity in financial statements in arriving at the fair value. Where this adjustment is reflected in income statements as gain or losses, it remains a contentious issue if it should be applied in computing distributable profit
5. **Management Compensation Plan:** Because of the new financial statements reporting format envisaged under IFRS which is quite different from Nigeria GAAP, the terms and conditions relating to management compensation plans would have to be changed. Therefore, contracts terms and conditions of management staff will be re-negotiated.
6. **Reporting Systems:** Companies will need to ensure that existing business reporting model is amended to suit the disclosure and reporting requirements of IFRS which is distinct from Nigeria reporting requirements. To correct this anomaly, information systems should be put in place to capture new requirements relating to fixed assets, segment disclosures, related party transaction, etc. Good internal control would help minimize the risk of business disruptions
7. **Issues of scale:** Implementation barriers associated with the relative costs of compliance for small and medium sized entities and accounting firms

3.5 TAX IMPLICATIONS OF IFRS ADOPTION

The Federal Inland Revenue Service (FIRS) in 2013 published an information circular on the tax implications of adopting IFRS. The key highlights are as follows:

- 1) **Transition adjustments** - Taxpayers are required to present a reconciliation of their IFRS transition adjustments for tax purposes
- 2) **Minimum Tax** - The new net asset based on IFRS adoption shall not be adopted for minimum tax computation in the year of transition.
- 3) **Excess dividend tax** – where dividend paid exceeds taxable profit excess dividend tax at 30% will apply notwithstanding that profit being distributed may have resulted from transition adjustments
- 4) **Extension of time for filing returns** – First time adopters of IFRS would on

application in accordance with Section 26 (5) of the Federal Inland Revenue Service Establishment Act (FIRSEA) (and provisions of Self-Assessment Regulations 2012) be granted 3 months extension for filing of their first set of IFRS Financial statements and related returns to allow sufficient time to overcome initial conversion problems.

- 5) **Decommissioning** - Provision/estimate of cost of abandonment, dismantling, removing the item of property, plant and equipment (PPE) and site restoration shall not be allowed for capitalisation with PPE.
- 6) **Revaluation** – Cost (and tax written down value) is the basis of capital allowance computation, FIRS shall continue to disregard all revaluation of PPE. Any revaluation surplus shall not be taxable while deficit shall not be an allowable deduction.
- 7) **Asset valuation fees** - Professional fees and valuation expenses relating to revaluation of PPE shall not be allowed for tax purposes.
- 8) **Componentisation**– The breakdown of componentised PPE inclusive of the basis for determining the value of each component shall be filed with the FIRS as it shall form the basis of capital allowance claims and applicable rates.
- 9) **Interest free loan**: when it relates to individual, it shall be regarded as benefit in kind and taxed under the provisions of the Personal Income Tax Act (PITA) . In the case of corporate taxpayer, it shall be treated in line with Transfer Pricing Regulations. In all cases, the interest rate to be used shall be Monetary Policy Rate (MPR) plus a spread to be determined by the Finance Minister in line with Section 32(1) of FIRS Act.
- 10) **Impairment** - all impairment losses shall not be allowed for tax purposes.
- 11) **Intangible assets** - certain intangible assets such as software, franchise, and website cost will qualify for tax deduction based on amount amortised over the useful life.
- 12) **Discontinued Operation** - Cessation rule shall apply when a taxpayer discontinues a line of business and commencement rule will apply if the line of business is bought over by another party at arm's length in line with Section 29 (9) of Company Income Tax Act (CITA)
- 13) **Financial Instruments** - classified as **Fair Value Through Profit or Loss (FVTPL)** or held for trading are revenue in nature and therefore liable to CITA.
- 14) **Fair value measurement** - All gains and losses that may arise from fair value measurement shall be disregarded for tax purposes

4.0 CONCLUSION

The desire for Nigeria to achieve her vision 20 in the year 2020 of being the number one nation in Africa led to her to adopt IFRS in 2011. This adoption was done to foster the economic development of the country amongst other functions. However, there are challenges of such adoption and other implications on tax practices as discussed in this unit.

5.0: SUMMARY

This unit discussed the history of accounting standards in Nigeria, reasons for the adoption of IFRS and its challenges, as well as tax implications of IFRS adoption.

6.0 TUTOR-MARKED ASSIGNMENT

1. Which body formed the NASB?
2. What led to the replacement of NASB by FRCN?
3. State at least 5 roles of FRCN.
4. State five reasons for adopting IFRS in Nigeria?
5. Highlight the challenges of IFRS adoption in Nigeria
6. Discuss the implications of the adoption of IFRS on taxation

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MODULE 3: ACCOUNTING FOR MULTINATIONAL CORPORATIONS

UNIT 1: THE MULTINATIONAL CORPORATIONS

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 MEANING OF MULTINATIONAL CORPORATIONS
 - 3.2 CHARACTERISTICS OF MULTINATIONAL COMPANIES (MNCS)
 - 3.3 ADVANTAGES OF MULTINATIONAL COMPANIES (MNCS)
 - 3.4 DISADVANTAGES OF MULTINATIONAL COMPANIES (MNCS)
 - 3.5 MNCS AND CONSOLIDATED FINANCIAL STATEMENTS
 - 3.6 ACCOUNTING ISSUES OF MULTINATIONAL CORPORATIONS
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

World history suggests that, the growth in cross border trade led foreign investors to invest in countries and further establish branches across the globe especially in environments that have cheaper labour. This led to the establishment of Multinational corporations, the focus of this unit.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Explain the concept of Multinational corporations*
2. *Discuss the characteristics of MNCs*

3. *Highlight the Pros and cons of MNCS*
4. *Discuss the relationship between MNCs and consolidated financial statements.*
5. *Discuss the accounting issues of multinational corporations*

3.0 MAIN CONTENT

3.1 MEANING OF MULTINATIONAL CORPORATIONS

Multinational Corporation (MNC) is a business organization operating in more than one country. MNC can be defined as an undertaking which owns or controls productive or service facilities in more than one country, thus excluding mere exporters, even those with established sales subsidiaries abroad, as it does more licensors of technology. MNC is also referred to as “Multinational Company” or “International Company” or “Transnational corporation”.

Therefore, it can be defined as a main company (a parent company) manages a group of branches or subsidiaries in different countries to achieve certain objectives, by working together through a world managerial strategy under the constraints and laws in the home and host countries.

According to this definition of the MNC we can conclude the following facts about the MNC:

- There is a parent company in the home country where the Headquarter is.
- There are branches or subsidiaries in different countries (host countries).
- The branches or subsidiaries operate not only to achieve special objectives for themselves, but also for general objectives of the MNC as a whole, according to a certain international strategy.
- The parent company works under the laws of the home country, while the foreign branches or subsidiaries work under the applied laws in the host countries.
- The company must be controlling foreign offices, production, policies, quality, deadline and procedures.
- The product being produced must sooth the region where the company/branch is located.

The first multinational business organization was the Knights Templar, founded in 1120. After that came the British East India Company in 1600 and then the Dutch East India

Company, founded March 20, 1602, which became the largest company in the world for nearly 200 years (Nobes& Parker, 2008).

3.2 CHARACTERISTICS OF MULTINATIONAL COMPANIES (MNCS)

1. Geographical Spread: This geographical spread of MNCs places them in a considerable flexible position, because of the wide range of the multi-options in some decision areas, such as sourcing, pricing, financing, cash flow etc. The best MNC is able to take the advantage of changes in the economic environment internationally. The existence of networks of foreign affiliates within MNC gives the possibility of integrated production and marketing on a global basis. So, this may give rise to extensive intra-firm trade, such as various stages in the production process which are located in different countries or affiliates which specialize in a particular part of the total product line. The intra-transfers of MNC constitute a very significant part of the total volume of international trade.
2. The Efficiency: The magnitude of the available resources of MNCs enables it to distribute these resources wherever they want in different countries in the world. MNC can transport investments, money, people, machines, materials, goods, special technical knowledge and cleverness, and other services. All these are managed from a global and national perspective. This attitude of globalization in management thinking means that all affiliates are managed and controlled by the headquarters of the MNCs, but with a certain degree of the decentralization in some decision making areas. From this vantage point, the MNC is capable of tapping and manipulating its resources on a worldwide basis, using them in the locations considered to offer the best opportunities and/or the lowest risks. In other words, the MNC can generally obtain financing and produce its products at the lowest possible total costs, and also select the most promising available markets in which to sell.
3. The Power: The power attribute of the MNC is a result of its size, geographical spread, scope of operations, and efficiency. Today it is normal that the MNC records annual sales greater than GNP in some countries where it operates. Consequently, the MNC, as a giant among local firms, in general, has the power (at least in the economic sense) to dominate and control the local markets. Because the MNC lacks the protection of the international law, it relies upon itself to compete and win. For this, the MNC transcends

the national boundaries and controls to have the potential to influence the world affairs and course of events in the host countries in very significant ways.

4. The Flexibility: According to its size and scope, the MNC is certainly the most flexible of the economic enterprises. The excellent communication systems enable the widely decentralized operations to serve the local needs, and also permit the centralized direction to assure the goal congruence. Thus, the headquarters can manipulate the mobile resources of the MNC on a global basis, based upon the best overall interests for MNC. It can produce, assemble, and market in the locations offering the best opportunity. This kind of flexibility often enables the MNC to offset or escape from restrictive regulations or controls in certain sections of the world. Transfer prices, credit terms, loans, and other points are examples of devices available to the MNC.

3.3. ADVANTAGES OF MULTINATIONAL COMPANIES (MNCS)

1. They ensure optimum utilization of resources both in their domestic and foreign companies.
2. They represent risk-taking enterprise for advancement, development and the provision of services.
3. They provide capital investments where urgently needed.
4. They assist the development of emerging nations and distant regions, by generating investment-multiplier effects and invisible trade.
5. They are leaders in innovation, business methods and financial practices.
6. They prove the validity of international cooperation and regional schemes.
7. They provide advanced training of staffs and opportunity for employment and career development.
8. They allow a wide participation on their investments, thereby contributing support democracy.
9. They assist in the balance of payments between developed and developing regions.
10. They lead to international mobility and trade.
11. They launch nations on a path of the self-sufficiency.
12. They provide a framework of interlocking operations and financial strategies.

3.4 DISADVANTAGES OF MULTINATIONAL COMPANIES (MNCS)

1. They tend to exploit national resources.

2. They create tensions in the host countries in the political, social and economic aspects.
3. They foster excessive nationalism and anti-company feelings.
4. They exercise arbitrary control over their operations in the host countries to the exclusion of local factors.
5. They constitute crippling competition to the local enterprise.
6. They possess strong economic power and thereby exert unfair pressures and gain unfair advantages.
7. They tend to achieve economic domination over smaller economies.
8. They sometimes practice unethical business methods, such as pricing speculations, excessive royalties, loss accounting.
9. They tend to aggravate the host country's currency situation.
10. They have adverse effects on the motivation of their own staff, by the impersonal stratification of controls, thus stifle initiative and encourage risk avoidance.
11. They export capital and thereby jobs to the foreign countries.
12. They build up profits abroad at the expense of the home country.
13. They are insensitive to the local social and cultural values.

3.5 MNCS AND CONSOLIDATED FINANCIAL STATEMENTS

Consolidated financial statements combine the separate financial statements of two or more companies to yield a single set of financial statements as if the individual companies were really one. Multinationals are often required by the countries in which they do business to set up a separate corporation in each country. The point is that a legal entity is not necessarily the same as an economic entity. From an economic point of view, the activities of these various legal entities are centrally administered from corporate headquarters. Thus, the intent of consolidated financial statements is to provide financial accounting information about the group of companies from an overall perspective.

Consolidated financial statements first appeared around the turn of the 20th century in the United States. This was a time of great economic expansion during which a number of corporations grew into economic giants. The era witnessed a wave of corporate mergers. It is said that J.P. Morgan was so proud of his US steel company (the first billion-dollar company in the world) that he insisted on preparing and disseminating consolidated financial statements since the company's inception in 1901. Since holding companies first became important in the United States, it is not surprising that US accountants were the first to

experiment with consolidated financial statements.

Holding companies became important in Great Britain and Netherlands in the 1920s, so consolidated financial statements appeared there somewhat later than in the United States. Today, they are required in both countries. The practice moves much more slowly in the other European and non-European countries.

3.6 ACCOUNTING ISSUES OF MULTINATIONAL CORPORATIONS

The accounting issues of MNCs become numerous because of the complexity involved in managing and accounting for transactions in more than one country. These issues are discussed as follows:

1. Various accounting standards issues: accounting standards vary from one country to another and this influence significantly the overall financial reporting system of the MNCs. Although, Nigeria as adopted IFRS, not all countries have adopted as such there are differences in the recognition of intangible assets, asset measurement, financial instruments, provisions, employee benefits, deferred tax, revenue recognition, comprehensive income, and others. All these affect the consistency of the report being produced, for instance, the Last-In-First-Out (LIFO) method of inventory valuation is allowed under US GAAP and other local standards while this method is not allowed under the IFRS.
2. Foreign exchange fluctuations and translation issues: the issues of more than one country implies more than one currency, as such, there is need for the financial statements of subsidiaries in other countries to be translated to the parent's currency. The translation process sometimes can be in the form of transaction or the entire financial statements (will be discussed in module 4) which is influenced by the fluctuation in the exchange rates. These fluctuations affect the treatment of transactions in the translated financial statements.
3. Diversity in economic factors: an important macro-economic factor is level of inflation. The level of inflation in different countries influences their accounting treatments and procedures. Also, accounting systems are further influenced by tax laws which determine the treatment of financial transactions in the financial reports. These make consolidation of financial reports difficult for the MNCs.
4. Capital budgeting issues: in MNCs capital budgeting is seen to be complicated due to

associated risk with future cashflows. These risks include: political, economic and financial. The political risk is the probability that unexpected political events will affect the business such as, political unrest, unfavorable changes in labour laws, etc. Economic risks include the macro-economic factors that can influence the business such as inflation, etc. Financial risk involves the undesirable changes in financial factors that will affect the business. Such factors are interest rates, exchange rate, etc. The level of risk is usually country specific.

4.0 CONCLUSION

As discussed in the previous unit, one of the reasons for adopting IFRS in Nigeria is to reduce cost of preparing consolidated financial statements of Multinational corporations. MNCs are corporations with branches in more than one country and are required to provide consolidated financial statements irrespective of each individual country's accounting standards. These statements are prepared using the accounting standards of parent's country.

5.0 SUMMARY

This unit discussed meaning of MNCS, its characteristics, its pros and cons, its relationship with consolidated financial statements and its accounting issues.

6.0 TUTOR-MARKED ASSIGNMENT

1. What are the key elements in defining MNCs?
2. List at least five pros and cons of MNCs
3. Discuss five characteristics of MNCs
4. What is the relationship between MNCs and Consolidated financial statements?
5. State 4 accounting issues of MNCs.

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UNIT 2: PRESENTATION AND ANALYSIS OF FINANCIAL REPORTS BY MULTINATIONAL CORPORATIONS

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 DISCLOSURE WITH INTERNATIONAL PERSPECTIVE
 - 3.2 FINANCIAL STATEMENT ANALYSIS
 - 3.3 REASONS FOR FINANCIAL STATEMENTS' ANALYSIS
 - 3.4 TECHNIQUES OF FINANCIAL ANALYSIS
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

The previous unit discussed the concept of Multinational corporations and consolidated financial statements. This unit discusses the presentation and analysis of financial statements of multinational corporations.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

- 1. Discuss disclosures in financial statements with international perspective*
- 2. Explain the concept of financial statements analysis*
- 3. Highlight the techniques of financial statements analysis*

3.0 MAIN CONTENT

3.1 DISCLOSURE WITH INTERNATIONAL PERSPECTIVE

What, how much and how a company discloses supplemental information varies depending on certain criteria, these are:

- a) The requirements of generally accepted accounting principles.
- b) The needs of users.
- c) The influence of users.
- d) The philosophy of management.

This sub-unit would aimed at discussing certain examples of disclosure from an international perspective which are as follows

1. Segment disclosures

Consolidated financial statements combine the separate financial statements of a parent company and its subsidiaries so that a single set of financial statements is issued for the entire economic entity. The argument is that for a multinational corporation operating in a number of different product lines, consolidated financial statements may in fact hide some important information. If a company's continued profitability depends heavily on a certain region of the world or on a particular product, knowledge of that may be useful to shareholders, creditors, employees and other financial statement users. Thus, in addition to consolidated financial statements, perhaps companies should be more detail about where and how total profits are derived.

2. Financial Forecast Disclosures

Given that a primary concern of investors is assessing a company's future profitability and cash flows, it is reasonable to ask whether companies provide their own internal forecasts of such financial information. Financial forecasts would seem to be relevant information for investors. In practice, few MNCs provide them. One reason is that forecasts can be unreliable because they incorporate subjective estimates of uncertain future events. In addition, there can be legal repercussions for managements if the forecasts are not met. In litigious countries such as the United States, the potential for lawsuits is a major deterrent to providing financial forecasts.

3. Information about Shares and Shareholders

A number of continental European companies disclose rather extensive information about

their shares and shareholders. The value of such information is aimed at current and prospective shareholders. Past trend data can be useful in predicting future patterns and it is also useful when making comparisons with the trends of other companies. Shares are more marketable when they are traded on several exchanges and when the volume of trading is high. Widely scattered ownership tends to provide ready sales opportunities when present shareholders wish to dispose of some or all of their share holdings. Ownership concentration also indicates the locus of corporate control. On the other hand, dispersed ownership normally means that the company is controlled by shareholders and their agents, the company's management team. On the other hand, a concentrated ownership suggests that power is exerted by a more narrowly defined group. Management may be constrained if a large block of shares is owned by relatively few individuals or groups, and other shareholders may have relatively less influence in such situations. The identities of the largest shareholders might also be of interest to current and potential shareholders for the same reason. There are no standards that require companies to provide information about shares and shareholders, although, the practice seems to be growing.

3.2 FINANCIAL STATEMENT ANALYSIS

Analysts are employed in a number of functional areas. Commonly, analysts evaluate an investment in some type of security that has characteristics of equity (representing an ownership position) or debt (representing a lending position). In arriving at investment decisions or recommendations, analysts need to evaluate the performance, financial position, and value of the company issuing the securities. Company financial reports, which include financial statements and other data, provide the information necessary to evaluate the financial health of the company. Consequently, the analyst must have a firm understanding of the information provided in each company's financial reports, including the financial notes and other forms of supplementary information.

The role of financial reporting by companies is to provide information about their performance, financial position, and changes in financial position that is useful to a wide range of users in making economic decisions. The role of financial statement analysis is to take financial reports prepared by companies, combined with other information, to evaluate the past, current, and prospective performance and financial position of a company for the

purpose of making investment, credit, and other economic decisions. In evaluating financial reports, analysts typically have an economic decision in mind (Alexander, Britton, & Jorissen, 2009).

3.3 REASONS FOR FINANCIAL STATEMENTS' ANALYSIS

There are certain themes in financial analysis. In general, analysts seek to examine the performance and financial position of companies as well as forecast future performance and financial position. Analysts are also concerned about factors that affect risks to the company's future performance and financial position. An examination of performance can include an assessment of a company's profitability (the ability to earn a profit from delivering goods and services) and its cash flow – generating ability (the ability to produce cash receipts in excess of cash disbursements). Profits and cash flows are not equivalent. Profit represents the excess of the price at which goods or services are sold over all the costs of providing those goods and services (regardless of when cash is received or paid).

Although profitability is important, so is the ability to generate positive cash flow. Cash flow is important because, ultimately, cash is needed to pay employees, suppliers, and others to continue as a going concern. A company that generates positive cash flow from operations has more flexibility in funding needed investments and taking advantage of attractive business opportunities than an otherwise comparable company without positive cash flow. Additionally, cash flow is the source of returns to providers of capital. Therefore, the expected magnitude of future cash flows is important in valuing corporate securities and in determining the company's ability to meet its obligations. The ability to meet short-term obligations is generally referred to as **liquidity**, and the ability to meet long-term obligations is generally referred to as **solvency**.

3.4 TECHNIQUES OF FINANCIAL ANALYSIS

According to Robinson, Hennie, Elaine, and Michael (2009) some of the techniques are discussed as follows: (Note: the content of this course does not cover the intricacies of the techniques as they are to be learnt in details in other courses)

1. Ratios

There are many relationships between financial accounts and between expected

relationships from one point in time to another. Ratios are a useful way of expressing these relationships. Ratios express one quantity in relation to another (usually as a quotient). Examples of Ratios are: Profitability ratios (such as ROA, ROCE), liquidity ratio (Current ratio, acid ratio).

2. Common - Size Analysis

Common - size analysis involves expressing financial data, including entire financial statements, in relation to a single financial statement item, or base. Items used most frequently as the bases are total assets or revenue. In essence, common - size analysis creates a ratio between every financial statement item and the base item.

3. The Use of Graphs as an Analytical Tool

Graphs facilitate comparison of performance and financial structure over time, highlighting changes in significant aspects of business operations. In addition, graphs provide the analyst (and management) with a visual overview of risk trends in a business. Graphs may also be used effectively to communicate the analyst's conclusions regarding financial condition and risk management aspects.

4. Regression Analysis

When analyzing the trend in a specific line item or ratio, frequently it is possible simply to visually evaluate the changes. For more complex situations, regression analysis can help identify relationships (or correlation) between variables. For example, a regression analysis could relate a company's sales to gross domestic product (GDP) over time, providing insight into whether the company is cyclical. In addition, the statistical relationship between sales and GDP could be used as a basis for forecasting sales.

4.0 CONCLUSION

Financial statements on its own do not depict the full financial health of an organization without further analysis. Financial statement analysis includes techniques used by financial analysts to further understand and interpret financial statements of organizations for investment purposes.

5.0 SUMMARY

This unit discussed the disclosures in financial statements with international perspectives, the concept of financial statements analysis and its techniques.

6.0 TUTOR-MARKED ASSIGNMENT

1. List and explain five disclosures with international perspective
2. Differentiate between cash flow and profit; solvency and liquidity.
3. With examples, explain four techniques of financial statements analysis.

7.0 REFERENCES/FURTHER READINGS

Alexander, D., Britton, A., & Jorissen, A. (2009). *International Financial Reporting and Analysis*. 4th Edition. US: Cengage Learning.

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UNIT 3: PERFORMANCE EVALUATION IN MNCS

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 MEANING OF PERFORMANCE EVALUATION
 - 3.2 FINANCIAL MEASURES USED BY MNCS TO EVALUATE DOMESTIC AND FOREIGN SUBSIDIARIES
 - 3.3 ISSUES TO CONSIDER WHEN DEVELOPING MNC EVALUATION SYSTEMS
 - 3.4 RESPONSIBILITY ACCOUNTING AND PERFORMANCE EVALUATION IN MNCS
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT

1.0 INTRODUCTION

Within multinational corporations, there is need to measure the performance of the various branches. This unit discusses the meaning of performance evaluation, financial measures used by MNCS to evaluate domestic and foreign subsidiaries, issues to consider when developing MNC evaluation systems, responsibility accounting and performance evaluation in MNCS.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Discuss the concept of performance evaluation*

2. *Highlight financial measures used by MNCs to evaluate domestic and foreign subsidiaries*
3. *Discuss issues to consider when developing MNC evaluation systems*
4. *Explain the relationship between responsibility accounting and performance evaluation.*

3.0 MAIN CONTENT

3.1 MEANING OF PERFORMANCE EVALUATION

Performance evaluation is the periodic review of operations to ensure that the objectives of the enterprise are being accomplished. It is a multi-purpose tool used to measure actual performance against expected performance, provide an opportunity for the employee and the supervisor to exchange ideas and feelings about job performance, identify employee training and development needs, and plan for career growth. Performance evaluations are important tools used by management to review and discuss employees' performances.

Several types of performance evaluations exist, including 360-degree feedback, management by objectives and ratings scale evaluations. Regardless of the type of performance evaluation system used, managers perform evaluations to benefit employees and the employer. However, implementing performance evaluations offer advantages and disadvantages. Companies who recognize the disadvantages can make the necessary adjustments to receive the full benefits of implementing performance evaluations.

Benefits result from the Performance Evaluation process:

- Control of the work that needs to be done
- Enhancement of employee motivation, commitment, and productivity
- Identification of goals and objectives for the employee
- Satisfaction of the basic human need for recognition
- Identification of process improvement opportunities
- Identification of employee development opportunities

3.2 FINANCIAL MEASURES USED BY MNCS TO EVALUATE DOMESTIC AND

FOREIGN SUBSIDIARIES

MNCs use various measures to evaluate the results of their operations at home and abroad. Let us discuss some of the measures.

1. Profitability Measures

A fundamental measure of operating success is profitability. This can be expressed as gross profit, net income, or return on investment (ROI). Gross profit (or gross margin) is the difference between revenues and the cost of products sold or services provided. Net income is the “bottom line” profit figure of an operation. Expressed as a rate of return, ROI relates profitability to invested capital. It is said that since shareholders are profit oriented, manager should be as well. Profitability measures imply a level of decentralization that does not always exist in multinational operations.

2. Sales Growth and Cost Reduction

The ability to reach customers is vital to company’s long-run success. Customer acceptance of company’s products or services translates directly into the sales (or revenue) figure. Sales growth may also indicate increased market share. Because of an increase in globalization leading to high competition in the 1990s, cost reduction intensified. Cost reduction is the minimization of associated cost using certain techniques, an example is outsourcing functions such as accounting and information technology. Sales growth and cost reductions should also improve profitability.

3. Budgets as a Success Indicator

Sometime, budgeting has been accepted as a management tool for controlling operations and forecasting future operations of domestic companies. One purpose of the budget is to clearly set out the objectives of the entity. A budget generally provides a forecast and a means of comparing the actual results, of operations to the budget. This comparison produces variances that can be analyzed to evaluate performance and improve the efficiency of future operations.

When a budget is used for a foreign subsidiary, the budget should be developed by that subsidiary. The experience of the local manager is extremely important, in that, it produces adeep knowledge of the specific business situation. Thus, the subsidiary manager should fully

participate in establishing the subsidiary's goals and in developing its budget. A budget developed on this level will help control the operations and make achievement of goals possible. This budget can be used by the local manager on a daily basis.

Budgeting gives local managers the opportunity to set their own performance standards. In international operations, top management is not as familiar with what the standards should be. Headquarters must rely to a greater extent on good local or regional budgets, which help facilitate the strategic planning process.

The subsidiaries' budgets are approved at the parent-company level and often require the endorsement of the president and/or the board of directors. Presumably, headquarters uses the budget to consider the circumstances peculiar to each subsidiary. All of this should ensure a two-way flow of communication between the subsidiary and headquarters, which in turn, will improve the overall budgeting process.

3.3 ISSUES TO CONSIDER WHEN DEVELOPING MNC EVALUATION SYSTEMS

From previous studies and literatures it can be concluded that MNCs and their subsidiaries operate in different international environments, and the performance of the foreign subsidiaries is affected by some variables and factors such as: environmental factors (economic, legal, political, technological, cultural and social), transfer pricing, foreign currencies, and inflation. If the MNC want to evaluate the real performance of the foreign subsidiaries and their managers it must consider these factors and variables at performance evaluation process of foreign subsidiaries and their managers. But the MNC faces some problems and difficulties when it deals with these issues in the performance evaluation of foreign subsidiaries and their managers as the following:

1. Transfer Pricing

The transfer price (internal price) is the price at which goods and services are transferred (bought or sold) between members of MNC, for example, from parent to subsidiaries, between subsidiaries, and from subsidiaries to parent. The MNC often sets the transfer prices to maximize the global after-tax income or otherwise manoeuvre profits to lower tax rate countries. This may however, conflict with the real performance evaluation of foreign subsidiaries and their managers. The issue of transfer pricing in MNC is complicated by the fact that tax and custom authorities of different countries take an active interest in the

methods employed. Furthermore, MNCs can use transfer prices in a similar manner to reduce the impact of tariffs. Tariffs increase import prices and apply to inter-corporate transfers as well as to sales to unaffiliated buyers. Although no company can do much to change tariffs, the effect of tariffs can be lessened, if the selling company under-prices the goods it exports to the buying company. Under-pricing inter-corporate transfers can also be used to get more products into a country that is rationing its currency or otherwise limiting the value of goods that can be imported. The subsidiary can import twice as many products, if they can be bought at half the price.

2. Foreign Currencies

The accounting records and financial statements of the foreign subsidiaries are generally maintained in the subsidiary's local currency. The parent company must be able to translate these foreign currency financial statements to the currency of the parent company. The choice of currency, in which to evaluate the performance, is one of the problems of performance measurement and evaluation of foreign subsidiaries and their managers. What is the best method for the MNC in evaluating the real performance of the foreign subsidiaries and their managers in the local currency results or the results translated into the currency of the parent company? The MNC needs to translate the financial statements of its foreign subsidiaries for many reasons: (1) to record the transactions that are measured in a foreign currency, (2) to prepare consolidated financial statements which report on the economic entity as a whole, (3) to evaluate the operations of a foreign business segment, (4) to evaluate the performance of the management of the foreign subsidiaries, (5) to direct and control the foreign operations, and (6) for the convenience of users whether they are internal or external users.

The multinational companies use the current exchange rate method to translate the accounts of foreign subsidiaries from the currency of the host country into the currency of the parent company, because this method provides information, which reflect economic facts and the real performance of foreign subsidiaries and their managers

3. Inflation

Inflation is one of the environmental factors, which affecting the performance of multinational companies. It is considered as one of the variables (problems) that are out of control of subsidiary management. During inflation periods, the figures and information in the financial statements and reports are misrepresentative and may mislead the decision

makers; consequently, they affect the performance of the company. Thus, the multinational company must consider the effect of inflation on the financial statements and reports of the company, if it wants to measure and evaluate the real performance of foreign subsidiaries in the host countries. Doubtless, high inflation rates render accounting numbers fairly useless for performance evaluation. Without adjustments, realistic evaluations of units and management would be very difficult. Thus, a number of companies find it beneficial to adjust their financial statements for inflation and to discuss with their owners and shareholders the related impact on dividend policy and capital requirements. While other companies find it not beneficial to adjust their financial statements for inflation.

4. The effect of the environmental factors

The foreign subsidiaries operate in different international environments. Each environment may have economic, legal, political, cultural and social factors different from those in other environments. Because of these environmental factors it is possible to have a good management performance despite poor subsidiary performance, and vice-versa. Thus, if the MNC want to evaluate the real performance of foreign subsidiaries and their managers, it must eliminate the effect of these environmental factors from the performance of the foreign subsidiaries and their managers.

3.4 RESPONSIBILITY ACCOUNTING AND PERFORMANCE EVALUATION IN MNCs

The concepts of responsibility accounting are devised to place performance evaluation into manageable contexts. Responsibility accounting merely defines spheres of reference (responsibility centers) that had control over costs and / or revenues and to which inputs (resources) and outputs (products, services, or revenues) could be traced. These responsibility centers varied in complexity of control, structure, and purpose. The responsibility centers can be classified below:

Cost Centers: whenever controls and objectives are concerned, the cost centers are the simplest spheres of the responsibility centers. Control is exercised over incurred costs. Objectives normally call for the maximization of outputs, in quantity and quality, within the constraints on inputs specified by time and effort, standard cost, flexible budget, and similar systems. Structures vary from a single person, operation, or machine to the function of an

entire plant. In practice, control and evaluation are enhanced by breaking down structures into smallest components exercising control over costs.

Performance evaluations of cost centers are primarily financial and focus upon variances from predetermined standards. The better systems are based upon reasonably attainable standards, tailored to suit the responsibility centers, and revised as conditions change. Other quantitative, non-financial measures are often employed as well: number of reject products, machine breakdowns, employee turnovers, and alike. Qualitative assessment may be made by product engineers by using surrogate measures (such as using the numbers of grievances to judge employee attitudes), or all too often, by relegating assessments to consumers where products are concerned.

Revenue Centers: By definition, revenue centers can affect output levels (revenues) in relation to the inputs (resources represented in expense budgets), but no direct control is exercised over the costs of the products or services to be sold. Motivation and control are sought by means of budgeted revenues and expenses. The twin objectives are to maximize revenues while spending within authorized levels. Sales offices are typical revenue centers, often with further segmentation into product lines, territories, salesmen, and so on.

Performance evaluation usually begins with financial comparisons of actual and budgeted levels of revenues and expenses, after variable portion of the latter have been adjusted to reflect actual activity levels. Since the costs and qualities of the sold items are not controllable, appropriate adjustments should be made for any favourable or unfavourable effects caused by changes in these factors that are not recognized by budget revisions. Non-financial measures are also employed, although not necessarily in a systematic fashion (market shares, changes in sales mix, repeat sales, numbers of customers, quotas, calls made by salesmen, complaints, and others). The non-financial measures become increasingly important as inflation, which affects revenues expressed in monetary units.

Profit centers: The profit centers are units or divisions that have control over both costs and revenues. Performance evaluations relate outputs (revenues) with inputs (costs and expenses) by focusing on profits (revenues minus identifiable expenses). Profit is an absolute measure that in itself can be assessed as a subjective representation of the firm's financial health. At such, it becomes a more meaningful measure when relative comparisons are possible with budget, results of prior periods and profit of other divisions of the firm.

4.0 CONCLUSION

Multinational corporations usually measure the performance of its branches in order to determine their overall performance. Different performance evaluation techniques are used depending on the peculiarity of the business. Issues such as inflation, exchange rates fluctuations, transfer pricing and other environmental factors affect performance evaluation of MNCs.

5.0 SUMMARY

This unit discussed the meaning of performance evaluation, financial measures used by MNCs to evaluate domestic and foreign subsidiaries, issues to consider when developing MNC evaluation systems, responsibility accounting and performance evaluation in MNCs.

6.0 TUTOR-MARKED ASSIGNMENT

1. Define the concept of performance evaluation
2. List and explain five financial measures used by MNCs to evaluate domestic and foreign subsidiaries
3. Why consider inflation an issue when developing MNC evaluation systems?
4. Discuss performance evaluation of responsibility centers in MNCs.

MODULE 4: ACCOUNTING FOR FOREIGN OPERATIONS

UNIT 1: IAS 21 AND REPORTING FOREIGN CURRENCY TRANSACTIONS IN THE FUNCTIONAL CURRENCY

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 TERMINOLOGIES
 - 3.2 FOREIGN CURRENCY TRANSLATION OF DIRECT
BUSINESS TRANSACTIONS
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

Activities of home companies with foreign companies are generally divided into two categories, firstly, it can be on transaction basis and secondly, the home company can be a branch or subsidiary of the foreign company. Accounting guidelines for these two scenarios are treated by the IAS 21, however, the first scenario is considered in this unit while the second is considered in units 2 and 3. Thus, this unit provides in details the treatment a business considers on how to translate foreign currency amounts into its accounts when direct business transactions are involved.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Discuss the terminologies used in financial statements translation*

2. *Highlight direct business transactions and their treatment*

3.0 MAIN CONTENT

3.1 TERMINOLOGIES

Closing Rate: this is the exchange rate at the reporting date which is end of the reporting period.

Opening Rate: this is the exchange rate at the beginning of the reporting period.

Average Rate: this is derived by adding the opening rate and the closing rate divided by two

Monetary Items: are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency

Foreign currency is a currency other than the functional currency of the entity.

Spot exchange rate is the exchange rate for immediate delivery.

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

Net investment in a foreign operation is the amount of the reporting entity's interest in the net assets of that operation.

Reporting Currency: The improvement project to IAS 21 removed the notion of 'reporting currency' and replaced it with two further definitions of currency provided as follows:

1. **Functional currency:** this is the currency of the primary economic environment in which the entity operates
2. **Presentation currency:** this is the currency in which the financial statements are presented.

A foreign subsidiary: is a subsidiary whose activities are based and conducted in a country other than the country of the parent. Such as subsidiary may not constitute a foreign entity.

A Foreign Entity: is a foreign operation whose activities are not in integral part of those of the parent.

Exchange Rate: This could be defined a ratio at which the currencies of two countries are exchanged at a particular date.

Forward Rate: The exchange rate available by the terms of an agreement for the exchange of two currencies at a future date.

Closing Date: This is the spot rate that exists at the reporting date.

Foreign Currency: A currency other than the functional currency of the entity.

Monetary Items: Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.

3.2 FOREIGN CURRENCY TRANSLATION OF DIRECT BUSINESS TRANSACTIONS

There are situations where a business enters into a contract with a foreign currency and there arise the need to translate such transaction into the functional currency of the business for presentation purpose. Examples of such transactions are: Imports of raw materials, Exports of finished goods, Importation of non-current assets, Investments on foreign securities, Obtaining foreign loan, etc.

Such transactions may be required to be translated at more than one time in the accounts, for instance, the credit purchase of raw materials will affect the books and the subsequent payment will also affect the books especially in the era of exchange rate fluctuations. Also, the domestic value of an overseas long-term loan is likely to fluctuate from period to another.

The method of translation is as follows:

- i. Transactions during Accounting Period:** These should be translated and recorded at the rate of exchange ruling at the date of the transaction. In practice, an average rate might be used.
- ii. Monetary Items at reporting date:** Where these items such as receivables, payables, bank balances or loans are denominated in a foreign currency they should be translated and recorded at the closing rate or, if appropriate, at the rate at which the transaction is contracted to be settled that is at an agreed forward rate.

- iii. Non-monetary items at reporting date:** where these items are carried at cost less depreciation, they should be translated and recorded at the exchange rate at the date of acquisition. Where these items are carried at fair value less depreciation, they should be translated and recorded at the exchange rate at the date of revaluation.

Exchange difference: All exchange difference should be reported as part of profit for the year.

It is also important to differentiate between functional currency and presentation currency. IAS 21 suggests that when determining its functional currency, the entity has to consider the primary economic environment where an entity operates in which it primarily generates and expends cash.

ILLUSTRATION I

An entity operating in Nigeria has various buildings in Ghana that are determined in US Dollars and payments can be made in US dollars or cedes. Determine the entity's functional currency.

Solution

The functional currency is Cedes because;

1. The local circumstances in Ghana determine the rental yield.
2. Presumably labour and other expenses are paid in Cedes

ILLUSTRATION 2

On 20 October 2016 an entity with a functional currency of Naira buys raw materials from a supplier on credit for \$1,000. At the end of the accounting period the entity is yet to pay the debt. The entity has a financial year-end of 31 December 2016.

The spot exchange rates are as follows:

- 20 October 2016: ₦250/\$1
- 31 December 2016: ₦280/\$1

Required: show the journal entries for the above transactions at initial recognition and end of

the year.

Solution

At initial recognition: the purchase is recorded on 20th October, 2016 as follows:

	Dr(₦)	Cr(₦)
Purchases (\$1000* ₦ 250)	250,000	
Trade Payable (\$1,000* ₦ 250)		250,000

Being the initial recognition of purchase of raw materials

On 31st December 2016, the trade payables will be retranslated at the closing rates as follows:

$$\$1,000 * \text{₦}280 = \text{₦}280,000$$

Exchange rate difference amount to:

$$\text{₦}280,000 - \text{₦}250,000 = \text{₦}30,000$$

Thus;

	Dr(₦)	Cr(₦)
Profit or loss (Exchange difference)	30,000	
Trade Payable (Exchange difference)		30,000

Being the exchange rate difference arising from the credit purchase of raw materials during the year

Note: the trade payables will reflect ~~₦~~280,000 at the end of the period while if the raw materials have not been used, sold or impaired will still be recognized at ~~₦~~250,000.

4.0 CONCLUSION

Specific business transactions of home companies with foreign companies usually require special treatment as highlighted in IAS 21. This is as a result of exchange rate fluctuation because an entity that obtains foreign loan of \$1,000 in January of 2016 with an expectation

to pay back the same \$1,000 in December of the same year will not be paying back the same naira value especially where there is no specific agreed rate.

5.0 SUMMARY

This unit provides in details the treatment of translation of direct business transactions and exchange difference arising therefrom.

6.0 TUTOR-MARKED ASSIGNMENT

1. An entity operating in Nigeria has majority of his clients in Dubai and transactions are usually made in US dollars or Dirham. Determine the entity's functional currency.
2. On 1/1/2015 an entity with a functional currency of Naira obtained a foreign loan of £750. At the end of the accounting period the entity is yet to pay the debt. The entity has a financial year-end of 31 December 2015. The spot exchange rates are as follows:

- 1/1/2015: ₦450/£1
- 31/12/2015: ₦580/£1

Required: show the journal entries for the above transactions at initial recognition and end of the year.

7.0 REFERENCES/FURTHER READINGS

IAS 21: *The effect of changes in foreign exchange rates.*

UNIT 2: IAS 21 AND FINANCIAL STATEMENT TRANSLATION OF FOREIGN OPERATIONS: FOREIGN BRANCHES

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 METHODS OF TRANSLATION
 - 3.2 DETERMINATION OF METHOD TO ADOPT
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

As discussed in the previous unit, the home company can be a subsidiary or branch of the foreign company. Both scenarios require for the home company to prepare their accounts in their functional currency and there exist the need to subsequently translate the financial statements to the presentation currency of the foreign company. The procedures for translating the financial statements of foreign branches are discussed in this unit.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

- 1. Discuss the methods of financial statements translation*
- 2. Explain the ways to determine the method to adopt*
- 3. Translate the financial statements of a branch*

3.0 MAIN CONTENT

3.1 METHODS OF TRANSLATION

The IAS 21 does not give an enterprise the freedom to choose which method of translation should be used. It lays down the circumstances in which each particular method must be used. There are basically three methods as provided in the standards and these are explained as follows:

i. **Closing rate method:**

This method is to be used when the foreign operations do not form an integral part of the activities of home company. Under this method:

Item	Translation Rate
Assets and Liabilities	Closing rate
Items of Profit or loss	Closing rate

The method is also referred to as current rate method. Arising exchange difference will be adjusted to reserves.

ii. **Temporary method:**

This method is used when foreign operations form an integral part of the activities of home country company. Here:

Item	Translation Rate
Current Assets and Liabilities	Closing rate
Non-current assets and liabilities	Historical rate
Statement of Comprehensive Income items	Average rate

This method is sometimes referred to as current-non-current method. Arising exchange difference will be adjusted to statement of Comprehensive Income.

iii. **Monetary and non-monetary:**

Under this method, monetary assets and liabilities are translated to the rate ruling at the Reporting date and non-monetary assets and liabilities at the historical rate at the date they were acquired or incurred. Assets and liabilities are regarded as monetary if their nominal values are fixed.

3.2 DETERMINATION OF METHOD TO ADOPT

The method to be used will be determined by the business of the home country in association with the foreign operations. Some of the clues include:

- When goods sent to the branch by the head office constitute a high proportion of goods by the branch, then the temporal method is used while closing method will be suitable if otherwise.
- If the branch relies on funding from the head office, the temporal method is suitable while the closing method should be used if the branch is independent in terms of funding. (Shiyanbola, 2015)

ILLUSTRATION I

Shugarine Enterprise operates in Nigeria with a branch in Ghana, Dudu Enterprise. The financial statements prepared in Cede (Ghana Currency) were as follows:

Dudu Enterprises

Statement of Profit or Loss for the year ended 31st December, 2016

	Cedi	Cedi
Turnover		850,000
Less cost of sales		
Opening inventory	355,750	
Add purchases	<u>120,500</u>	
	476,250	
Closing inventory	<u>206,420</u>	<u>(269,830)</u>
Gross profit		580,170
Depreciation	18,000	
Operating expenses	<u>142,820</u>	<u>(160,820)</u>
Net profit		<u>419,350</u>

Dudu Enterprises

Statement of Financial Position as at 31st December, 2016

<u>Non-current assets (Net Book Value)</u>	Cedi	Cedi
Furniture and Fittings	562,000	
Motor Vehicles	<u>120,000</u>	682,000

Current assets

Closing inventory	206,420
Account receivables	110,000
Cash at bank	<u>85,000</u>
	401,420

Current liabilities

Current account	128,500		
Account payables	<u>140,000</u>	<u>(268,500)</u>	<u>132,920</u>
			<u>814,920</u>
Financed by			
Retained profit			634,700
Long term debts			<u>180,220</u>
			<u>814,920</u>

Additional information for the period was given as follows:

- The head office current account and the tangible assets were agreed at when the exchange rate was ₦0.20/1cedi on 01/01/2014.
- On 1/1/2016 the retained earnings was ₦23,500
- The exchange rates for cedi during the period were:
1/1/2016 ₦0.56/1cedi
31/12/2016 ₦0.73/1cedi

Required:

Translate the financial statement of Dudu Enterprises into Naira using temporal method.

Solution

Dudu Enterprises				
<u>Statement of Profit or Loss for the year ended 31st December, 2016</u>				
	Cedi	Cedi	Rate ₦	₦
Turnover		850,000	0.645	548,250

Less cost of sales					
Opening inventory	355,750		0.56	199,220	
Add purchases	<u>120,500</u>		0.645	<u>77,723</u>	
	476,250			276,943	
Closing inventory	<u>(206,420)</u>	<u>(269,830)</u>	0.73	<u>(150,687)</u>	<u>(126,256)</u>
Gross profit		580,170			421,994
Depreciation	18,000		0.2	3,600	
Operating expenses	<u>142,820</u>	<u>-160,820</u>	0.645	<u>92,119</u>	<u>(95,719)</u>
Net profit		<u>419,350</u>			326,275
Exchange Loss (wk 2)					<u>(179,799)</u>
Retained earnings (wk 1)					<u>146,476</u>

Dudu Enterprises

Statement of Financial Position as at 31st December, 2016

<u>Non-current assets (NBV)</u>	Cedi	Cedi	rate	₦	₦	₦
Furniture and Fittings	562,000		0.2	112,400		
Motor Vehicles	<u>120,000</u>	682,000	0.2	<u>24,000</u>		136,400
<u>Current assets</u>						
Closing inventory	206,420		0.73	150,687		
Account receivables	110,000		0.73	80,300		
Cash at bank	<u>85,000</u>		0.73	<u>62,050</u>		
	401,420				293,037	
<u>Current liabilities</u>						
Current account	128,500		0.2	25,700		
Account payables	<u>140,000</u>	<u>-268,500</u>	0.73	<u>102,200</u>	<u>127,900</u>	<u>165,137</u>
		<u>814,920</u>				<u>301,537</u>
Financed by						
Retained profit		634,700	derived			169,976
Long term debts		<u>180,220</u>	0.73			<u>131,561</u>
		<u>814,920</u>				<u>301,537</u>
Workings				₦		
1. Retained earnings (derived)					169,976	

Less balance as at 1/1/2016	-23500
Net increase in retained earnings	<u>146476</u>
2. Net Profit derived	326,275
Less net increase in retained earnings	<u>(146476)</u>
Exchange loss	<u>79,799</u>
3. Average rate= $(0.56+0.73)/2 = 0.645$	

4.0 CONCLUSION

Financial statements of foreign branches usually require translation whether the branches are integral parts of the head office or not. The procedures for translation usually result to exchange difference as highlighted in this unit.

5.0 SUMMARY

This unit discussed the procedures for translating the financial statements of foreign branches and subsequent treatment of exchange difference arising.

6.0 TUTOR-MARKED ASSIGNMENT

In Accordance with IAS 21 and relevant IFRS, translate the financial statements of God is Able Bank LTD for the year ended 31/12/2012 below to dollars(\$) using the following assumptions: Opening exchange rate: \$1= ₦150 Closing exchange rate: \$1= ₦165.

GOD IS ABLE BANK LIMITED

Statement of Financial Position as at December, 2012

	31/12/12	
	₦	₦
Cash	12,233	4,212
Balances with banks:		
Central Bank of Nigeria	2,595	7,557
Due from other banks in Nigeria	14,979	4,200
Due from banks outside Nigeria	3,700	3,000
Money on call and Short notice	<u>5,357</u>	<u>2,500</u>
Total cash & cash Equivalents	38,864	21,469
Stabilization securities	26,262	16,262

Investment and trading securities (YBs & BAs)	12,000	10,000
Advance-overdraft	55,000	20,000
Loans (net)	70,000	21,000
Advances under finance Lease	11,700	10,000
Accrued interest	400	600
Prepayments	3,000	2,000
Investment in sub/associated undertakings	987	637
Property, plant and equipment	<u>1,650</u>	<u>1,500</u>
	<u>219,863</u>	<u>103,468</u>
Deposit and other Accounts	130,850	69,850
Certificates of Deposits	54,650	14,650
Negotiable certificate of deposit	5,000	2,000
Interest payable	350	200
Accrued expenses	3,445	500
Taxes payable	525	450
Dividend payable	200	200
Other borrowing	1,350	1,525
Long-term borrowings	6,700	5,000
Capital and Reserves		
Called-up capital	7,700	4,700
Reserves	<u>9,093</u>	<u>4,393</u>
	<u>219,863</u>	<u>103,468</u>

GOD IS ABLE BANK LIMITED

Statement of Comprehensive Income

FOR THE YEAR ENDED 31 DECEMBER, 2012

	₦	₦
Interest income		16,550
Interest expenses		<u>(12,145)</u>
Net interest income		4,405
Provision for loan losses		(2,580)
Other incomes:		
Fees and commission	6,235	
Lease income	100	

Gain on sale of equipment	200	
Gain on sale of trading investment Securities	2,680	
Dividend received	<u>100</u>	
		<u>9,225</u>
		11,050
Expenses		
Operating Expenses	(3,500)	
Depreciation	<u>(200)</u>	<u>(3,700)</u>
Profit before taxation		7,350
Provision for income taxes		<u>(1,550)</u>
Profit after taxation		5,800
Dividend declared		<u>(1,100)</u>
Transfer to reserves		<u>4,700</u>

7.0 REFERENCES/FURTHER READINGS

IAS 21: *The effect of changes in foreign exchange rates.*

Siyanbola, T. T. (2015). *Advanced financial accounting (IFRS compliant)*. Nigeria, Lagos: Gastos Consults.

UNIT 2: IAS 21 AND FINANCIAL STATEMENT TRANSLATION OF FOREIGN OPERATIONS: CONSOLIDATED FINANCIAL STATEMENTS

Content

- 1.0 INTRODUCTION
- 2.0 OBJECTIVES
- 3.0 MAIN CONTENT
 - 3.1 FINANCIAL STATEMENTS OF FOREIGN OPERATIONS
 - 3.2 STEPS INVOLVED IN TRANSLATING FINANCIAL STATEMENTS OF FOREIGN SUBSIDIARIES
- 4.0 CONCLUSION
- 5.0 SUMMARY
- 6.0 TUTOR-MARKED ASSIGNMENT
- 7.0 REFERENCES/FURTHER READINGS

1.0 INTRODUCTION

As discussed in the previous unit, the home company can be a subsidiary of the foreign company and as such their financial statements require translation before being consolidated with the parent company's account. The introductory aspect of consolidation is not covered in this course as it is expected to be treated in financial accounting course. Thus, this unit provides into details the procedures for translating the financial statements of foreign subsidiaries.

2.0 OBJECTIVES

By the end of this unit, you should be able to:

1. *Discuss the types of relationship between parent and subsidiaries*
2. *Highlight the steps involved in financial statements translation of foreign subsidiary*

3. *Translate the financial statements of foreign subsidiary*

3.0 MAIN CONTENT

3.1 FINANCIAL STATEMENTS OF FOREIGN OPERATIONS

Companies frequently establish local branches or subsidiaries in foreign countries through which to conduct their operations. These will maintain the accounts in the local currency and these must clearly be translated into the currency of the parent before they can be consolidated.

The translation method to be used depends on relationship between parent and foreign enterprise.

1. **Quasi autonomous foreign enterprise**

Where the foreign enterprise is relatively independent of its parent, its transactions do not impinge directly on cash flows and profit of the parent. Accordingly, it is the net investment in the foreign enterprise which is of interest rather than the individual assets and liabilities. This net investment is translated using the closing rate method and the resulting difference will be treated in the reserves

When the Net Investment Concept is Appropriate

The following is a list of indications that a foreign operation is a foreign enterprise (requiring the closing rate method) rather than a foreign operational with the same functional currency as the reporting enterprise (which would require the temporal methods)

- i. The foreign enterprise carries out its activities with a significant degree of autonomy.
- ii. Transactions with the reporting enterprise are not a high proportion of the foreign enterprise's activities.
- iii. The foreign enterprise is mainly financed from its own operations or local borrowings.
- iv. Costs of labour, material etc are primarily paid for in the local currency rather than in the reporting currency.
- v. The foreign enterprise's sales and mainly in currencies other than the reporting currency.

- vi. Cash flows of the reporting enterprise are not directly affected by the activities of the foreign enterprise.

When using the closing rate or what is termed as net investment method of translating the local currency financial statements with the group having the features:

- investment of the company is in the net worth of its foreign enterprise rather than a direct investment in individual assets and liabilities;
- the foreign enterprise is not dependent on the currency of the investment company for its day to day operations;
- here the amount in the foreign enterprise statement of financial position will be translated into the investing company's currency using the rate ruling at financial year end;
- any exchange difference arising from the retranslation of the opening net investment in a foreign enterprise at the closing rate should be recorded as a movement on reserves;
- all profit or loss transactions should be translated at closing rate or average rate for the period provided that, where the latter is used, the difference between the profit or loss item translated at an average rate and at the closing rate shall be recorded as a movement on reserve.

2. Foreign operations that are integral to the operations of the parent:

Where the enterprise is, in reality, the parent enterprise operating abroad, foreign transactions will impinge directly on cash flows and profits of the parent. Accordingly, the foreign enterprise's functional currency is effectively the currency of the parent, and so the foreign enterprise's should be accounted for as if they were those of the parent by translation according to the **temporal method**.

When the Temporal method is Appropriate

In exceptional circumstances, the foreign operations may be regarded as an extension of the trade of the parent enterprise. This would apply where the cash flows of a subsidiary impact directly on the parent enterprise. Examples of such situations are where:

- (a) The subsidiary acts as a selling agency receiving goods from the parent enterprise, selling them locally and remitting the proceeds to the parent enterprises; or
- (b) The subsidiary is a supplier of raw materials or components to the parent enterprise; or
- (c) The subsidiary is located overseas for tax, exchange control or similar reasons to act as a means of raising finance for other companies in the group.

In such cases the temporal (single enterprise) method should be used.

Note:

Exchange difference arising from translation of financial statements of a foreign entity is not passed through Statement of Comprehensive Income, but is taken directly to shareholder interest, whereas that arising from translation of the financial statements of a foreign subsidiary, which is integral to the operations of the parent, is reported in the Statement of Comprehensive Income.

3.2 STEPS INVOLVED IN TRANSLATING FINANCIAL STATEMENTS OF FOREIGN SUBSIDIARIES

1. As usual construct the group structure
2. Translate the subsidiary company's statement of financial position converting all assets and liabilities using the conversion rate ruling at the end of the financial year; OSC and pre-acquisition Reserves using the conversion rate at date of acquisition. The net difference between the total assets and OSC + pre-acquisition Reserves amounts to post acquisition Reserve;
3. Translate the statement of profit or loss and other comprehensive income of the subsidiary company using average rate for the year;
4. Compute the goodwill in the subsidiary in foreign currency to be later translated at the conversion rate ruling at the end of the financial year;
5. Net off goodwill translated at the rate ruling at the acquisition date against goodwill translated at conversion rate at the end of the financial year to derive exchange gain or loss on goodwill to be transferred to Consolidated Reserve;
6. Also net off goodwill translated at the rate ruling at the beginning of the financial year against goodwill valued at the rate ruling at the end of the financial year to derive exchange gain or loss on goodwill to be recognized as other comprehensive income in the statement of profit or loss and other comprehensive income;

7. Compute consolidated Reserve in the usual manner in addition to the transfer of exchange gain or loss mentioned in Step 5 above;
8. Compute the NCI at the end of the financial year in the usual manner, using the appropriate conversion rate;
9. Finally compute the exchange difference on translated of subsidiary company's net asset by comparing the translated net asset in Step 2 against the translated net asset using the conversion rate ruling at the beginning of the financial year and also the translated profit for the year explained in Step 3.

ILLUSTRATION

ABC limited, a Nigerian conglomerate, acquired 80% share in XYZ limited, based in South Africa, when the exchange rate was 4.0 rand to ₦1 and the latter enterprise's reserve stood at 75,000 rand as at that date. The financial position of the companies at 31 December, 2006 was as follows:

	ABC Limited		XYZ Limited
Assets	₦'000		₦'000
Freehold property at cost	500,000		550,000
Furniture and fittings at cost	380,000		650,000
Accumulated depreciation	(38,000)		(120,000)
Plant and Machinery at cost	520,000		200,000
Accumulated depreciation	<u>(160,000)</u>	<u>(100,000)</u>	
	1,202,000		1,180,000
Investment in XYZ Limited	100,000		
Inventory	190,000		132,000
Cash at Bank	92,000	32,000	
Account Receivable	<u>150,000</u>	<u>93,000</u>	
	<u>1,734,000</u>		<u>1,437,000</u>
Equity and Liabilities			
Ordinary Share Capital	500,000		400,000
Revenue Reserves	<u>634,000</u>	<u>437,000</u>	

	1,134,000	837,000
Non-current Liabilities	200,000	350,000
Current Liabilities	<u>400,000</u>	<u>250,000</u>
	<u>1,734,000</u>	<u>1,437,000</u>

Statement of Profit or Loss for the year ended 31 December, 2006

	ABC Limited	XYZ Limited
₦'000		₦'000
Revenue	2,500,000	1,800,000
Cost of sales	<u>1,200,000</u>	<u>1,100,000</u>
profit	1,300,000	700,000
Other Income	97,000	80,000
Distribution cost	(125,000)	(110,000)
Administration expenses	(354,000)	(250,000)
Finance cost	<u>(93,000)</u>	<u>(100,000)</u>
Trading Profit before Taxation	825,000	320,000
Taxation	<u>400,000</u>	<u>250,000</u>
year	425,000	70,000
Other Comprehensive Income	<u>7,500</u>	
Total Comprehensive Income	<u>432,500</u>	<u>70,000</u>

The following additional information is available:

During the year ended 31 December, 2006 ABC Limited sold goods amounting to ₦100m to XYZ Limited. None of the inventory remained in the book of the latter company. The effect of the transfer has also been accounted for in arriving at the turnover and cost of sales of ABC and XYZ respectively;

It is the policy of the group to measure non-controlling interest at acquisition at the proportion of net identifiable assets of subsidiary.

The following exchange rates are relevant:

January 1, 2005	4.0 rand to ₺1
Average for the year 2006	5.0 rand to ₺1
December 31, 2005	4.8 rand to ₺1
December 31, 2006	6.0 rand to ₺1

Required

As the Group Financial Controller of ABC Limited, you are required to prepare the necessary financial statement that would be useful to the board, including relevant explanations that would make the statements understandable to the stakeholders of the company.

SOLUTION

ABC Plc

Consolidated Statements of Financial Position at 31 December, 2006

Assets	₺'000	
Property, Plant and Equipment (1,202,000 + 196,667 W2)	1,398,667	
Intangible Assets – Goodwill (W4)	<u>3,333</u>	
Total Non-current Assets	1,402,000	
Current Assets		
Inventory (190,000 +22,000 W2)	212,000	
Receivables (150,000 +15,500 W2)	165,500	
Cash (92,000 +5,333 W2)	97,333	<u>474,833</u>
Total Assets		<u>1,876,833</u>
Equity and Liabilities		
Ordinary share capital		500,000
Consolidated Revenue Reserve (W7)	<u>648,933</u>	
		1,148,933
Non-controlling interest at year end (W8)		<u>27,900</u>
Total Equity		1,176,833
Non-current Liabilities (200,000 + 58,333 W2)		258,333
Current Liabilities (400,000 + 41,667 W2)		<u>441,667</u>
Total Equity and Liabilities		<u>1,876,833</u>

ABC Plc

Consolidated Statements of Profit or Loss and other comprehensive Income for the year
ended 31 December, 2006

		¥'000
Revenue (2,500,000 +360,000 W3)	2,860,000	
Cost of sale (1,200,000 + 220,000 W3)	<u>1,420,000</u>	
Gross Profit		1,440,000
Other Income (97,500 + 16,000 W3)	<u>113,500</u>	
	1,553,500	
		Distribution cost
(125,000 + 22,000 W3)	147,000	
Admin. Expenses (354,000 + 50,000 W3)	<u>404,000</u> (551,000)	
1,002,500	Finance cost (93,500 + 20,000 W3)	
<u>113,500</u>	Profit before Taxation	
889,000		Less Taxation
<u>450,000</u>	Profit for the year	
439,000	Other Comprehensive Income:	
Parent company	7,500	
Exchange difference on net assets(W9)	(34,292)	
Exchange loss on goodwill (W9)	<u>(833)</u> (27,625)	
Total comprehensive income		<u>411,375</u>
Profit attributable to:		
Non-controlling interest (W3)		2,800
Owners of parent company (439,000 - 2800)		<u>436,200</u>
Total		<u>439,000</u>
Total comprehensive income attributable to :		
Non-controlling interest (W3)		2,800
Owners of parent company (411,375 - 2800)	<u>408,575</u>	
Total	<u>411,375</u>	

Workings

W1	Group Structure	Group	NCI
	ABC in XYZ	80%	20%

W2 Translation of subsidiary statement of financial position – 31/12/2006

Assets	R'000	Exchange rate	¥'000
Freehold properties		550,000	R6.00 91,667
Furniture and fittings		650,000	R6.00 108,333
Accumulated depreciation		(120,000)	R6.00 (20,000)
Plant and Machinery		200,000	R6.00 33,333
Accumulated depreciation		<u>(100,000)</u>	R6.00 <u>(16,667)</u>
Property, Plant & Equipment		1,180,000	196,667
Inventory	132,000	R6.00	22,000
Receivables	93,000	R6.00	15,500 Bank
	<u>32,000</u>	R6.00	<u>5,333</u>
Total Assets		1,437,000	239,500
Less liabilities			
Non-current liabilities		(350,000)	R6.00 (58,333)
Current liabilities		<u>(250,000)</u>	R6.00 <u>(41,667)</u>
Net Asset		<u>837,000</u>	<u>139,500</u>
Equity			
Ordinary share	400,000	R4.00	100,000
Revenue Reserve:			
Pre-acquisition Res.		75,000	R4.00 18,750
Post Res. (437,000 + 75,000)		<u>362,000</u>	balancing figure <u>20,750</u>
Total Equity		<u>837,000</u>	<u>139,500</u>

W3 Translation of statement of profit or loss and other comprehensive income for the year ended 31 December, 2006

R'000	rate of exchange	¥'000
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Revenue	1,800,000	R5.00	360,000
Cost of sales	<u>1,100,000</u>	R5.00	<u>220,000</u>
Gross profit	700,000		140,000
Other Income	80,000	R5.00	16,000
Distribution cost	(110,000)	R5.00	(22,000)
Administration expenses	(250,000)	R5.00	(50,000)
Finance cost	<u>(100,000)</u>	R5.00	<u>(20,000)</u>
Profit before Taxation	320,000		64,000
Less Taxation	<u>250,000</u>	R5.00	<u>(50,000)</u>
Profit for the year	70,000		14,000
Attributable to:			
NCI at 20%	<u>(14,000)</u>	<u>(2,800)</u>	
Owners of parent company	<u>56,000</u>	<u>11,200</u>	

W4	Computation of Goodwill in Subsidiary company	R'000
	Consideration Transferred: (₦100,000 @ R4.00)	400,000
	Add NCI at proportionate of net asset 20%(475,000)	<u>95,000</u>
	Total consideration	495,000
	Less FV of net asset acquired:	
	Ordinary share capital	400,000
	Pre- Reserves	<u>75,000</u>
	Goodwill valued in Rand	<u>20,000</u>
	Translation to naira value at end of the year (R6)	<u>3,333</u>

W5	Computation of exchange gain or loss on goodwill in consolidated reserve	₦'000
	Goodwill valued at end of the year rate i.e. R6	<u>(5,000)</u>
	Goodwill valued at acquisition date rate	<u>(1,667)</u>
	Exchange loss on goodwill in consolidated reserves	

W6	Computation of exchange gain or loss on goodwill in income statement	3,333
	Goodwill valued at end of the year rate	<u>(4,166)</u>
	Goodwill valued at the beginning of the year rate	<u>(833)</u>
	Exchange loss on goodwill in income statement	

W7	Computation of revenue reserves	634,000
	Parent company: balance per statement of financial position	16,600
	Group share of post acquisition reserve of subsidiary (80%*20,750)	<u>(1,667)</u>
	Exchange loss on goodwill (W5)	<u>648,933</u>
	Consolidated revenue reserve	
W8	Non-controlling interest at year end	23,750
	NCI at acquisition (W4) i.e R95,000 at R4:₦1	<u>4,150</u>
	NCI share of post acquisition reserve in sub (20%*20,750)	<u>27,900</u>
	NCI at year end	
W9	Computation of exchange difference on translated net assets of subsidiary	
	Translated net asset of subsidiary (W2)	139,500
	Less: expected net asset at end of the year:	
	Equity of subsidiary in Rand (W2)	837,000
	Less profit for the year in Rand (W3)	<u>70,000</u>
	Net asset at end of the last year (2005)	<u>767,000</u>
	Translated into naira at 31/12/05 rate i.e. ₦4.80	(159,792)
	Less translated profit for the year (W3)	<u>(14,000)</u>
		<u>(34,292)</u>

Notes

- The working was based on the policy that non-controlling interest is measured at proportionate of net assets acquired
- Note the fact that assets and liabilities were translated at rate ruling at the end of the financial year except for the share capital and pre-acquired reserves that were valued at conversion rate ruling at the date of acquisition and also the fact that post-acquisition reserves represent the balancing figure after netting off the share capital and pre-acquired reserves from the translated net assets of subsidiary, as shown in the workings 2 above.

- Also, revenue and expenses items were translated at average conversion rate ruling during the financial year period.
- The goodwill was firstly calculated using the foreign rate before eventual conversion to the parent company currency. Pay special attention to the way the initial consideration was accounted for. As it was in the book of the parent company, it is necessary to convert it to the subsidiary currency, as the initial computation was in subsidiary company's currency.
- Aside from the computation of NCI in working 8 that follows the usual format, all other workings from working 5 to 9 should be closely studied and all entries traced to their respective corresponding legs in the book.

Question and solution adapted from Siyanbola (2015).

4.0 CONCLUSION

Financial statements of foreign subsidiaries usually require translation and the procedures for translation usually result to exchange difference as highlighted in this unit.

5.0 SUMMARY

This unit provides details into the procedures for translating the financial statements of foreign subsidiaries.

6.0. TUTOR-MARKED ASSIGNMENT

You are the consolidation accountant of School. School prepares its financial statements using International Accounting standards. School has a subsidiary, House, House is incorporated in a country that has the Cedi as its unit of currency and the Cedi is the functional currency of House. The financial statements of School and House for the year ended 30 June 2011 are given below.

STATEMENT OF FINANCIAL POSITION AT 30 JUNE 2011

	School	House		
	₦'000	₦'000	Cedi'000	Cedi'000
Non-current assets				
Property, plant and equipment	30,000		50,000	

Investment in Away	14,000		
		44,000	50,000
Current assets			
Inventories	10,000	16,000	
Receivables	12,000	18,000	
Cash	<u>60</u>	<u>80</u>	
		<u>22,060</u>	<u>34,080</u>
		<u>66,060</u>	<u>84,080</u>
Capital and reserves			
Issued share capital (₵1/Cedi1 shares)		25,000	40,000
Reserves		<u>29,060</u>	<u>24,080</u>
		54,060	64,080
Current liabilities			
Trade payables	7,000	11,000	
Tax	1,000	2,000	
Proposed dividend	1,000	2,000	
Bank overdraft	<u>3,000</u>	<u>5,000</u>	
		<u>12,000</u>	<u>20,000</u>
		<u>66,060</u>	<u>84,080</u>

INCOME STATEMENTS FOR THE YEAR ENDED 30 JUNE 2011

	School	House
	₵'000	Cedi'000
Revenue	12,000	20,000
Cost of sales	<u>(6,000)</u>	<u>(10,000)</u>
Gross profit	6,600	10,000
Operating expenses	(3,000)	(5,000)
Finance cost	<u>(100)</u>	<u>(200)</u>
Profit before tax	2,900	4,800
Income tax expense	<u>(900)</u>	<u>(1,600)</u>

Net profit for the period 2,000 3,200

Notes to the financial statements

i. On 1 July 2005, School purchased 30 million shares in House for 42 million Cedi. The balance on the reserves of Cedi on 1 July 2005 was 8 million cedis. House has not issued any additional share since 1 July 2005.

ii. Relevant rates of exchange are as follows

Date	Exchange rate (cedi to ₦1)
1 July 2005	3
30 June 2010	3.75
30 June 2011	4

Required:

- i. Translate the Statement of Financial Position of House into Naira (₦) using the presentation currency*
- ii. Prepare the Consolidated Statement of Financial Position of the School group 30 June 2011*
- iii. Prepare the consolidated income statement of the School Group for the year 30 June 2011.*

7.0. REFERENCES/FURTHER READINGS

IAS 21: *The effect of changes in foreign exchange rates.*

Siyanbola, T. T. (2015). *Advanced financial accounting (IFRS compliant)*. Nigeria, Lagos: Gastos Consults.