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Economic Challenges of International Migration: a Comparative Study of Accounting Adaptation

Summary. Formalized and standardized accounting principles are necessary to enable business organizations to produce high-quality, relevant, accurate and comparable financial statements. With the progress of economic globalization and technology advances, as more and more corporations get involved in cross-border operations, the question arises whether there is a need to align the United States Generally Accepted Accounting Principles with the International Financial Reporting Standards. The continued growth of international businesses and multinational corporations raises accounting and tax issues around the prices at which goods and services are to be transferred internationally through business-to-business transactions. At the same time, another challenge comes up regarding what method should be used to translate foreign currency financial statements in order to consolidate them with those of the parent company. The paper offers a critical analysis of transfer pricing, illustrated with a specific example and an overview of approaches to translating foreign currency financial statements.

Keywords: economic challenges, international migration, financial accounting principles, adaptation, IFRS, GAAP

1. Introduction

Development of US GAAP, IFRS and the need to Converge. In the United States (U.S.), the FASB (Financial Accounting Standards Board) issued Statements of Financial Accounting Standards (SFASs) and these specific accounting methods and procedures are known as GAAP (Generally Accepted Accounting Principles). According to Schroeder, Clark and Cathey (2013), the FASB ASC (Accounting Standards Codification) are the single source of GAAP since July 1, 2009 and became effective for interim and annual periods after September 15, 2009. On the other hand, with the globalization of trade and economy in the latter half of the 20th century, multinational corporations emerged and a need for consistent international accounting standards was created. The IASB (International Accounting Standards Board) was formed in 1973, which issue the IFRSs (International Financial Reporting Standards) [Schroeder, Clark, Cathey 2013].

Although the FASB has been a member of the group that formulates IFRS, with IFRS gaining popularity by the years, there was a growing need for a uniform set of accounting principles that can be used by European companies and U.S. companies with cross-national businesses. Therefore Chatterjee (2015) points out, European companies, which were listed at the SEC (Securities and Exchange Commission) were protesting about the requirement to file form 20-F to reconcile their financial statements prepared as per IFRS with the U.S. GAAP. On the other hand, accounting scandals like Enron were pointing to loopholes in the existing standards and regulations in the United States, which lead the SEC to consider looking deeper into the principles based accounting standards like the IFRS, as opposed to the rules-based U.S. GAAP (p. 3).

The differences between IFRSs and U.S. GAAP were one of the primary reasons for this and are discussed in detail in the following section.

2. Literature Review

The academic literature about how U.S. GAAP and IFRS recognize revenue typically focuses on the theoretical differences in principles. Along with the real FASB and the International Accounting Standards Board (IASB) concepts and statements, many scholars in accounting have tried to point to the main fundamental differences in how every recognizes revenue. Along with these articles that attempt to demonstrate the fundamental, conceptual differences in revenue recognition principles, numerous articles as well evaluate the modern situation concerning the efforts by the FASB and the IASB to converge the two standards.

These papers that attempt to specifically explain the fundamental differences between U.S. GAAP and IFRS are extremely important, however there also are several other academic pieces regarding recognizing revenue from a historical perspective. The seminal paper that describes how companies must recognize revenue is John H. Myers's The Critical Event and Recognition of Net Profit. In his paper, Myers (1952) describes earnings as being earned during an operating cycle. The cycle of buying inventory with cash to eventually resell makes up the operating cycle.

The dilemma that now faces the company is for that company to choose at what point they recognize revenue. Should revenue be recognized at a specific point in the cycle, or should it be swell over the cycle in some manner?

This specific point where a company decides to recognize revenue is what Myers refers to as the critical event. Myers states for a number of companies it is simple to define the critical event. For magazine publishers, they recognize revenue in the period the magazines are distributed. The exchange is quite simple: the sale occurs, and cash is received at the time the subscription is booked [Myers 1952]. For software companies, the critical event is not that easy to define.

For example, because of bundling of services and multiple-deliverable arrangements, it becomes more hard to define the critical event for software companies when they recognize revenue.

Along with these extra historical papers, there are also a few papers that describe basic differences in GAAP and IFRS. The most significant of these essential differences is that U.S. GAAP tends to be more rules-based, while IFRS tends to be more principles-based. All of these papers' methodologies differ among case studies, comparative analyses, and descriptive analyses.

3. Conceptual Framework

Globalization of economies and rapid technological advancements has opened up cross-border trade for companies. Multinational Corporations often engage in inter-company sales of goods, services and other resources to optimize efficiency maximize profits, minimize taxes and other expenses. Transfer pricing situations arise when such inter-company sales are undertaken by multinational corporations.

Meaning of transfer pricing. When multinational corporations undertake intercompany transactions, how is the pricing strategy determined? According to McKinley and Owsley (2013), "A transfer price is the price charged between related parties (e.g., a parent company and its controlled foreign corporation) in an intercompany transaction".

Detailed explanation of transfer pricing. Intercompany transactions are eliminated during consolidation of the financial results of the parent with that of the foreign subsidiaries. However, transfer prices have a direct impact on the allocation of group-wide taxable income across national tax jurisdictions, since the domestic parent and the controlled foreign subsidiary's financial results are not consolidated for tax purposes as per Sec. 1504(b)(3) of the Tax Code [McKinley, Owsley 2013]. Therefore, fundamentally, the interests and conflicting goals of three parties are associated with transfer pricing strategies of a multinational corporation – the tax--minimizing goal of the taxpayer (for example, the domestic controlling company), the tax-revenue maximizing goal of the domestic tax authorities and the tax-revenue maximizing goal of the respective international tax authorities.

Issues in transfer pricing. The risks and issues arising from international transfer pricing are as follows:

Determination of arm's length transfer price. The IRS (Internal Revenue Service) wants to ensure that multinational corporations engaged in inter-company transfer of goods and services use arm's length transfer price so they can be taxed correctly. Code Sec. 482 states that a taxpayer should realize the same amount of income from a controlled transaction as an uncontrolled party would have realized from a similar transaction [Wharton, n.d.]. Since comparable transactions are not always available (for example, when a company transfers unique parts), hence in such cases, taxpayers may use two or more comparable uncontrolled transactions, thereby creating an arm's length range [Wharton, n.d.]. Sec 482 gives the IRS power to reallocate gross income, deduction, credits or allowances between organizations controlled by the same interest when they engage in transfer pricing [Hoffman, Raabe, Smith, Maloney 2014].

Transfer pricing creates UTP (Uncertain Tax Position) issues. As tax authorities can question and change or reallocate income arising from transfer pricing practices, transfer-pricing practices create Uncertain Tax Positions or UTPs. According to McKinley & Owsley (2013), transfer pricing not only has a direct impact on a company's tax provision, but may also have indirect effects on the ability to realize deferred tax assets.

Convergence to IFRS would create more complications with transfer pricing related issues. Transfer pricing creates uncertainties and complexities with the existing U.S. GAAP principles and IRS regulations. Wider adoption of IFRS would further complicate the matter. Therefore, McGowan & Wertheimer (2009) point out that adoption of the IFRS would affect the transfer pricing agreements and cost allocations across jurisdictions, and at the same time balance sheet allocations required under IFRS will also have transfer-pricing implications (for example to allocate intangible assets and goodwill).

Methods of Transfer Pricing. As per OECD (Organization for Economic Co-operation and Development), the following transfer-pricing methods can be used to determine arm's length price – Comparable Uncontrolled Price (CUP) method, Cost Plus method, Resale Price method, Profit Based Methods (like the transactional net margin method or TNMM, profit split method, etc.), a combination of methods (though not necessary, but may be used for complex transactions) [Hughes, Nicholls 2010].

Ethics. Multinational corporations like Microsoft, Apple Inc. etc., use the existing transfer pricing rules to shift their operating profits to subsidiaries (like those in Ireland) with lower tax-rates. Since these incomes would not be taxed at the U.S. Corporate tax rates till they are repatriated back to the United States, the ethical question arises whether to allow such practice or change the tax regulations. At the same time the other ethical question is that whether the best tax management solution for such multinational corporation (like minimizing the tax for the consolidated business of the parent company) is actually in the best interest of the revenue earned by the government through corporate taxes or not.

4. List of Countries that Have Adopted the IFRS and the Impact of Cultural Differences on the Interpretation of IFRS

List of countries that have adopted the IFRS. Before listing the countries that have adopted the IFRS so far, the meanings of adoption and convergence to IFRS are explained. According to IFRS (2016), adoption implies that the publicly listed companies are required to use IFRS (as issued by the IASB) as per a specific timetable set by the SEC. On the other hand, convergence involves the joint effort by IASB and FASB to develop high quality, compatible accounting standards over time (AICPA or American Institute of Certified Public Accountants, 2016).

The move towards a single global set of accounting standards gained momentum in 2002 when the FASB and IASB started working together. In 2005, the European Union or EU required companies incorporated in its member states whose securities were listed in any EU-regulated stock exchange to use IFRS standards for preparing financial statements. Australia, New Zealand and Israel converted in 2006 while Canada converted in 2011. According to the IFRS resources from AICPA, there are 90 countries till date that have fully adopted the IFRS standards while 30 other countries have permitted their use for listed companies [Satin, Huffman 2015]. The countries that have fully or partially adopted the IFRS for their domestic listed or unlisted companies, include the following: United Arab Emirates (UAE), Albania, American Samoa, Angola, Anguilla, Antigua and Barbuda, Argentina, Armenia, Aruba, Austria, Australia, Azerbaijan, Bahamas, Bahrain, Bangladesh, Barbados, Belgium, Belarus, Belize, Bermuda, Bolivia, Bosnia and Herzegovina, Botswana, Brazil, Brunei, Bulgaria, Cambodia, Canada, Cayman Islands, Chile, Colombia, Costa Rica, Croatia, Cyprus, Czech Republic, Denmark, Dominica, Dominican Republic, Dubai, Ecuador, El Salvador, Eritrea, Estonia, Fiji, Finland, France, Gambia, Germany, Georgia, Ghana, Gibraltar, Grenada, Greece, Greenland, Guatemala, Guyana, Haiti, Honduras, Hong Kong, Hungary, Iceland, India (permitted for consolidated results only), Iraq, Ireland, Israel, Italy, Jamaica, Japan, Jordan, Kazakhstan, Kenya, South Korea, Kuwait, Kyrgyzstan, Laos, Latvia, Lebanon, Liberia, Liechtenstein, Lesotho, Lithuania, Luxembourg, Libya, Macau, Macedonia, Madagascar, Malawi, Malaysia, Maldives, Malta, Mauritius, Mexico, Moldova, Mongolia, Montenegro, Morocco, Mozambique, Myanmar, Namibia, Netherlands, Netherlands Antilles, Nepal, New Caledonia, New Zealand, Nicaragua, Nigeria, Norway, Oman, Pakistan, Panama, Papua New Guinea, Peru, Poland, Portugal, Qatar, Reunion, Romania, Russia, Samoa, St. Kitts and Nevis, Saudi Arabia, Serbia, Sierra Leone, Slovenia, Slovak Republic, South Africa, Spain, Sri Lanka, Suriname, Swaziland, Sweden, Switzerland, Taiwan, Tajikistan, Tanzania, Trinidad and Tobago, Turkey, Uganda, Ukraine, United Kingdom, Uruguay, Vanuatu, Venezuela, Virgin Islands (British), West Bank/Gaza, Yemen, Zambia, Zimbabwe (Deloitte, 2015). Hence, for domestic listed companies, 131 countries require or permit IFRSs while 112 countries require or permit IFRSs for unlisted companies [Deloitte 2015].

Impact of cultural differences on the interpretation of IFRS. Since IFRS is a principles based standard (requiring greater use of judgment than the U.S. GAAP), unequal application and different degree of picking and choosing portions of the IFRS by the different countries are some of the issues that impact the comparability, consistency of the financial statements prepared following the rules. The question that arises is that, does cultural differences between the different jurisdictions adopting the IFRS affect the interpretation of IFRS? The answer is an absolute yes. Tsakumis, Campbell and Doupnik (2009) therefore point out that “recent accounting research suggests that… national culture and language translation – could undermine the rigorous interpretation and application of IFRS and lead to a lack of comparability across countries” (para 3).

According to Hofstede, four cultural dimensions that impact core values include uncertainty avoidance, individualism, achievement orientation and power distance (Tsakumis, Campbell, Doupnik 2009). Conservatism and secrecy can be directly influenced by national culture. For example, in countries where people are generally more conservative (higher uncertainty avoidance, lower individualism and achievement orientation), accountants may defer the recognition of assets and other items that increase net income [Tsakumis, Campbell, Doupnik 2009]. On the other hand countries with higher uncertainty avoidance and power distance and lower individualism and achievement orientation would favor secrecy [Tsakumis, Campbell, Doupnik 2009]. These countries favoring secrecy would have a different impact on the disclosure requirements, transparency and hence comparability of financial statements than those countries that do not favor secrecy.

Since IFRSs are principles based, they usually require the use of judgment to interpret and apply. Hence countries with a higher risk-taking culture would have a chance of interpreting accounting terms and standards in a different way than countries with a more conservative culture. As an example, a study by Doupnik in 2003 found that German accountants assigned a lower numeric threshold to the term “probable” than their U.S. counterparts, and more were conservative to recognize construction contract loss (Tsakumis, Campbell, Doupnik 2009)! Other studies found that Greek and Brazilian accountants exhibited more secrecy than U.S. accountants [Tsakumis, Campbell, Doupnik 2009].

Hence, from the above observations, it gets clear that culture plays a big impact on the way accountants and other stakeholders of a country interpret accounting standards. Understanding the differences in the different cultures would become a necessity to understand the interpretation of IFRS standards in different countries. Hence, cultural awareness training would be beneficial for the multinational corporations and auditors to recognize, understand and determine the impact of cultural tendencies on interpretation of IFRS and their impact on financial results of the corporation’s [Tsakumis, Campbell, Doupnik 2009].

5. Conclusions

Comparability of important financial information, improving the quality of financial reporting and cost savings and are several of the key reasons for the need to have a homogeneous set of universal accounting standards. Other than as AICPA (2014) points out, “U.S. GAAP is the gold standard […] issuers without operations outside the United States may resist IFRS […] and significant costs associated with adopting IFRS outweighs the benefits” [Satin, Huffman 2015: 240]. Therefore, the SEC has late the total convergence from U.S. GAAP to IFRS in the United States and in its report of July 2012, the SEC recommended that further research needed to be done to moderate and resolve the differences between IFRS and GAAP.

The speedy growth of transnational corporations has formed exclusive accounting legal and tax-related issues. There is certainly a need for a global set of reporting standards for quality, relevant, cost-efficient, comparable financial statements. But, the existing differences between GAAP and IFRSs, as well as the collision of the cultural differences between the nations that have adopted the IFRSs have affected the explanation of the IFRSs. Therefore, the article concludes that further study needs to be done to resolve the differences between GAAP and

IFRSs as suggested by the SEC, before a total convergence between the two is undertaken.

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Ekonomiczne wyzwania międzynarodowej migracji: studium porównawcze z zakresu adaptacji standardów rachunkowości

Streszczenie. Sformalizowanie i ustandaryzowanie zasad rachunkowości pozwala firmom sporządzać rzetelne, miarodajne i porównywalne sprawozdania finansowe, a także wpływa pozytywnie na jakość tych sprawozdań. Wraz z postępującą globalizacją i rozwojem technologii rośnie liczba przedsiębiorstw zaangażowanych w operacje transgraniczne i w związku z tym rodzi się pytanie o potrzebę zharmonizowania amerykańskich standardów US GAAP z Międzynarodowymi Standardami Sprawozdawczości Finansowej (MSSF). W obliczu wzrostu firm działających na skalę międzynarodową i korporacji ponadnarodowych nasilają się wątpliwości natury księgowej i podatkowej dotyczące cen, po jakich towary i usługi powinny być transferowane za granicę w ramach transakcji pomiędzy powiązanymi podmiotami. Pojawia się też kwestia, jaką metodą posługiwać się przy konwersji sprawozdań finansowych sporządzonych w walucie obcej w celu ich konsolidacji ze sprawozdaniami finansowymi spółki dominującej. Artykuł zawiera krytyczną analizę zjawiska cen transferowych, oferując konkretny przykład oraz przegląd metod konwersji sprawozdań finansowych w walucie obcej.

Słowa kluczowe: wyzwania ekonomiczne, migracja międzynarodowa, zasady rachunkowości, adaptacja, MSSF, GAAP