Chapter One

Introduction to International Accounting

Learning Objectives

After reading this chapter, you should be able to

- Discuss the nature and scope of international accounting.
- Describe accounting issues confronted by companies involved in international trade (import and export transactions).
- Explain reasons for, and accounting issues associated with, foreign direct investment.
- Describe the practice of cross-listing on foreign stock exchanges.
- Explain the notion of global accounting standards.
- Examine the importance of international trade, foreign direct investment, and multinational corporations in the global economy.

WHAT IS INTERNATIONAL ACCOUNTING?

Most accounting students are familiar with financial accounting and managerial accounting, but many have only a vague idea of what international accounting is. Defined broadly, the *accounting* in international accounting encompasses the functional areas of financial accounting, managerial accounting, auditing, taxation, and accounting information systems.

The word *international* in international accounting can be defined at three different levels.[1] The first level is supranational accounting, which denotes standards, guidelines, and rules of accounting, auditing, and taxation issued by supranational organizations. Such organizations include the United Nations, the Organization for Economic Cooperation and Development, and the International Federation of Accountants.

[1] This framework for defining international accounting was developed by Professor Konrad Kubin in the preface to *International Accounting Bibliography 1982–1994,* distributed by the International Accounting Section of the American Accounting Association (Sarasota, FL: AAA, 1997).

At the second level, the company level, international accounting can be viewed in terms of the standards, guidelines, and practices that a company follows related to its international business activities and foreign investments. These would include standards for accounting for transactions denominated in a foreign currency and techniques for evaluating the performance of foreign operations.

At the third and broadest level, international accounting can be viewed as the study of the standards, guidelines, and rules of accounting, auditing, and taxation that exist within each country as well as comparison of those items across countries. Examples would be cross-country comparisons of (1) rules related to the financial reporting of plant, property, and equipment; (2) income and other tax rates; and (3) the requirements for becoming a member of the national accounting profession.

Clearly, international accounting encompasses an enormous amount of territory—both geographically and topically. It is not feasible or desirable to cover the entire discipline in one course, so an instructor must determine the scope of an international accounting course. This book is designed to be used in a course that attempts to provide an overview of the broadly defined area of international accounting but that also focuses on the accounting issues related to international business activities and foreign operations.

EVOLUTION OF A MULTINATIONAL CORPORATION

To gain an appreciation for the accounting issues related to international business, let us follow the evolution of Magnum Corporation, a fictional auto parts manufacturer headquartered in Detroit, Michigan.[2] Magnum was founded in the early 1950s to produce and sell rearview mirrors to automakers in the United States. For the first several decades, all of Magnum's transactions occurred in the United States. Raw materials and machinery and equipment were purchased from suppliers located across the United States, finished products were sold to U.S. automakers, loans were obtained from banks in Michigan and Illinois, and the common stock was sold on the New York Stock Exchange. At this stage, all of Magnum's business activities were carried out in U.S. dollars, its financial reporting was done in compliance with U.S. generally accepted accounting principles (GAAP), and taxes were paid to the U.S. federal government and the state of Michigan.

Sales to Foreign Customers

In the 1980s, one of Magnum's major customers, Normal Motors Inc., acquired a production facility in the United Kingdom, and Magnum was asked to supply this operation with rearview mirrors. The most feasible means of supplying Normal Motors UK (NMUK) was to manufacture the mirrors in Michigan and then ship them to the United Kingdom, thus making export sales to a foreign customer. If the sales had been invoiced in U.S. dollars, accounting for the export sales would have been no different from accounting for domestic sales. However, Normal Motors required Magnum to bill the sales to NMUK in British pounds (£), thus creating foreign currency sales for Magnum. The first shipment of mirrors to NMUK was

[2] The description of Magnum's evolution is developed from a U.S. perspective. However, the international accounting issues that Magnum is forced to address would be equally applicable to a company headquartered in any other country in the world.

invoiced at £100,000 with credit terms of 2/10, net 30. If Magnum were a British company, the journal entry to record this sale would have been:

Dr. Accounts receivable (+ Assets)	£100,000	
Cr. Sales revenue (+ Equity)		£100,000

However, Magnum is a U.S.-based company that keeps its accounting records in U.S. dollars (US$). To account for this export sale, the British pound sale and receivable must be translated into US$. Assuming that the exchange rate between the £ and US$ at the time of this transaction was £1 = US$1.60, the journal entry would have been:

Dr. Accounts receivable (£) (+ Assets)	US$160,000	
Cr. Sales revenue (+ Equity)		US$160,000

This is the first time since its formation that Magnum found it necessary to account for a transaction denominated (invoiced) in a currency other than the U.S. dollar. The company added to its chart of accounts a new account indicating that the receivable was in a foreign currency, "Accounts receivable (£)," and the accountant had to determine the appropriate exchange rate to translate £ into US$.

As luck would have it, by the time NMUK paid its account to Magnum, the value of the £ had fallen to £1 = US$1.50, and the £100,000 received by Magnum was converted into US$150,000. The partial journal entry to record this would have been:

Dr. Cash (+ Asset)	US$150,000	
Cr. Accounts receivable (£) (− Asset)		US$160,000

This journal entry is obviously incomplete because the debit and credit are not equal and the balance sheet will be out of balance. A question arises: How should the difference of US$10,000 between the original US$ value of the receivable and the actual number of US$ received be reflected in the accounting records? Two possible answers would be (1) to treat the difference as a reduction in sales revenue or (2) to record the difference as a separate loss resulting from a change in the foreign exchange rate. This is an accounting issue that Magnum was not required to deal with until it became involved in export sales. Specific rules for accounting for foreign currency transactions exist in the United States, and Magnum's accountants had to develop an ability to apply those rules.

Through the British-pound account receivable, Magnum became exposed to foreign exchange risk—the risk that the foreign currency will decrease in US$ value over the life of the receivable. The obvious way to avoid this risk is to require foreign customers to pay for their purchases in US$. Sometimes foreign customers will not or cannot pay in the seller's currency, and to make the sale, the seller will be obliged to accept payment in the foreign currency. Thus, foreign exchange risk will arise.

Hedges of Foreign Exchange Risk

Companies can use a variety of techniques to manage, or hedge, their exposure to foreign exchange risk. A popular way to hedge foreign exchange risk is through the purchase of a foreign currency option that gives the option owner the right, but not the obligation, to sell foreign currency at a predetermined exchange rate known as the strike price. Magnum purchased such an option for US$200 and was able to sell the £100,000 it received for a total of US$155,000 because of the option's strike price. The foreign currency option was an asset that Magnum was required to account for over its 30-day life. Options are a type of derivative financial instrument,[3] the accounting for which can be quite complicated. Foreign currency forward contracts are another example of derivative financial instruments commonly used to hedge foreign exchange risk. Magnum never had to worry about how to account for hedging instruments such as options and forward contracts until it became involved in international trade.

Foreign Direct Investment

Although the managers at Magnum at first were apprehensive about international business transactions, they soon discovered that foreign sales were a good way to grow revenues and, with careful management of foreign currency risk, would allow the company to earn adequate profit. Over time, Magnum became known throughout Europe for its quality products. The company entered into negotiations and eventually landed supplier contracts with several European automakers, filling orders through export sales from its factory in the United States. Because of the combination of increased shipping costs and its European customers' desire to move toward just-in-time inventory systems, Magnum began thinking about investing in a production facility somewhere in Europe. The ownership and control of foreign assets, such as a manufacturing plant, is known as foreign direct investment. Exhibit 1.1 summarizes some of the major reasons for foreign direct investment.

Two ways for Magnum to establish a manufacturing presence in Europe were to purchase an existing mirror manufacturer (acquisition) or to construct a brand-new plant (greenfield investment). In either case, the company needed to calculate the net present value (NPV) from the potential investment to make sure that the return on investment would be adequate. Determination of NPV involves forecasting future profits and cash flows, discounting those cash flows back to their present value, and comparing this with the amount of the investment. NPV calculations inherently involve a great deal of uncertainty.

In the early 1990s, Magnum identified a company in Portugal (Espelho Ltda.) as a potential acquisition candidate. In determining NPV, Magnum needed to forecast future cash flows and determine a fair price to pay for Espelho. Magnum had to deal with several complications in making a foreign investment decision that would not have come into play in a domestic situation.

First, to assist in determining a fair price to offer for the company, Magnum asked for Espelho's financial statements for the past five years. The financial statements had been prepared in accordance with Portuguese accounting rules, which were much different from the accounting rules Magnum's managers were familiar with. The balance sheet did not provide a clear picture of the company's

[3] A derivative is a financial instrument whose value is based on (or derived from) a traditional security (such as a stock or bond), an asset (such as foreign currency or a commodity like gold), or a market index (such as the S&P 500 index). In this example, the value of the British-pound option is based on the price of the British pound.

EXHIBIT 1.1
Reasons for Foreign Direct Investment

Source: Alan M. Rugman and Richard M. Hodgetts, *International Business: A Strategic Management Approach* (New York: McGraw-Hill, 1995), pp. 64–69.

Increase Sales and Profits

International sales may be a source of higher profit margins or of additional profits through additional sales. Unique products or technological advantages may provide a comparative advantage that a company wishes to exploit by expanding sales in foreign countries.

Enter Rapidly Growing or Emerging Markets

Some international markets are growing much faster than others. Foreign direct investment is a means for gaining a foothold in a rapidly growing or emerging market. The ultimate objective is to increase sales and profits.

Reduce Costs

A company sometimes can reduce the cost of providing goods and services to its customers through foreign direct investment. Significantly lower labor costs in some countries provide an opportunity to reduce the cost of production. If materials are in short supply or must be moved a long distance, it might be less expensive to locate production close to the source of supply rather than to import the materials. Transportation costs associated with making export sales to foreign customers can be reduced by locating production close to the customer.

Protect Domestic Markets

To weaken a potential international competitor and protect its domestic market, a company might enter the competitor's home market. The rationale is that a potential competitor is less likely to enter a foreign market if it is preoccupied protecting its own domestic market.

Protect Foreign Markets

Additional investment in a foreign country is sometimes motivated by a need to protect that market from local competitors. Companies generating sales through exports to a particular country sometimes find it necessary to establish a stronger presence in that country over time to protect their market.

Acquire Technological and Managerial Know-How

In addition to conducting research and development at home, another way to acquire technological and managerial know-how is to set up an operation close to leading competitors. Through geographical proximity, companies find it easier to more closely monitor and learn from industry leaders and even hire experienced employees from the competition.

assets, and many liabilities appeared to be kept off-balance-sheet. Footnote disclosure was limited, and cash flow information was not provided. This was the first time that Magnum's management became aware of the significant differences in accounting between countries. Magnum's accountants spent much time and effort restating Espelho's financial statements to a basis that Magnum felt it could use for valuing the company.

Second, in determining NPV, cash flows should be measured on an after-tax basis. To adequately incorporate tax effects into the analysis, Magnum's management had to learn a great deal about the Portuguese income tax system and the taxes and restrictions imposed on dividend payments made to foreign parent companies. These and other complications make the analysis of a foreign investment much more challenging than the analysis of a domestic investment.

Magnum determined that the purchase of Espelho Ltda. would satisfy its European production needs and also generate an adequate return on investment. Magnum acquired all of the company's outstanding common stock, and Espelho Ltda.

continued as a Portuguese corporation. The investment in a subsidiary located in a foreign country created several new accounting challenges that Magnum previously had not been required to address.

Financial Reporting for Foreign Operations

As a publicly traded company in the United States, Magnum Corporation is required to prepare consolidated financial statements in which the assets, liabilities, and income of its subsidiaries (domestic and foreign) are combined with those of the parent company. The consolidated financial statements must be presented in U.S. dollars and prepared using U.S. GAAP. Espelho Ltda., being a Portuguese corporation, keeps its accounting records in euros (€) in accordance with Portuguese GAAP.[4] To consolidate the results of its Portuguese subsidiary, two procedures must be completed.

First, for all those accounting issues in which Portuguese accounting rules differ from U.S. GAAP, amounts calculated under Portuguese GAAP must be converted to a U.S. GAAP basis. To do this, Magnum needs someone who has expertise in both U.S. and Portuguese GAAP and can reconcile the differences between them. Magnum's financial reporting system was altered to accommodate this conversion process. Magnum relied heavily on its external auditing firm (one of the so-called Big Four firms) in developing procedures to restate Espelho's financial statements to U.S. GAAP.

Second, after the account balances have been converted to a U.S. GAAP basis, they then must be translated from the foreign currency (€) into US$. Several methods exist for translating foreign currency financial statements into the parent's reporting currency. All the methods involve the use of both the current exchange rate at the balance sheet date and historical exchange rates. By translating some financial statement items at the current exchange rate and other items at historical exchange rates, the resulting translated balance sheet no longer balances, as can be seen in the following example:

Assets	€ 1,000	×	$1.35	US$1,350
Liabilities	600	×	1.35	810
Stockholders' equity	400	×	1.00	400
	€ 1,000			US$1,210

To get the US$ financial statements back into balance, a translation adjustment of US$140 must be added to stockholders' equity. One of the major debates in translating foreign currency financial statements is whether the translation adjustment should be reported in consolidated net income as a gain or whether it should simply be added to equity with no effect on income. Each country has developed rules regarding the appropriate exchange rate to be used for the various financial statement items and the disposition of the translation adjustment. Magnum's accountants needed to learn and be able to apply the rules in force in the United States.

[4] Note that in 2005 Portugal adopted International Financial Reporting Standards for publicly traded companies in compliance with European Union regulations. However, as a wholly owned subsidiary, Espelho Ltda. continues to use Portuguese GAAP in keeping its books.

International Income Taxation

The existence of a foreign subsidiary raises two kinds of questions with respect to taxation:

1. What are the income taxes that Espelho Ltda. has to pay in Portugal, and how can those taxes legally be minimized?
2. What are the taxes, if any, that Magnum Corporation has to pay in the United States related to the income earned by Espelho in Portugal, and how can those taxes legally be minimized?

All else being equal, Magnum wants to minimize the total amount of taxes it pays worldwide because doing so will maximize its after-tax cash flows. To achieve this objective, Magnum must have expertise in the tax systems in each of the countries in which it operates. Just as every country has its own unique set of financial accounting rules, each country also has a unique set of tax regulations.

As a Portuguese corporation doing business in Portugal, Espelho Ltda. will have to pay income tax to the Portuguese government on its Portuguese source income. Magnum's management began to understand the Portuguese tax system in the process of determining after-tax net present value when deciding to acquire Espelho. The United States taxes corporate profits on a worldwide basis, which means that Magnum will also have to pay tax to the U.S. government on the income earned by its Portuguese subsidiary. However, because Espelho is legally incorporated in Portugal (as a subsidiary), U.S. tax generally is not owed until Espelho's income is repatriated to the parent in the United States as a dividend. (If Espelho were registered with the Portuguese government as a branch, its income would be taxed currently in the United States regardless of when the income is remitted to Magnum.) Thus, income earned by the foreign operations of U.S. companies is subject to double taxation.

Most countries, including the United States, provide companies relief from double taxation through a credit for the amount of taxes already paid to the foreign government. Tax treaties between two countries might also provide some relief from double taxation. Magnum's tax accountants must be very conversant in U.S. tax law as it pertains to foreign source income to make sure that the company is not paying more taxes to the U.S. government than is necessary.

International Transfer Pricing

Some companies with foreign operations attempt to minimize the amount of worldwide taxes they pay through the use of discretionary transfer pricing. Auto mirrors consist of three major components: mirrored glass, a plastic housing, and a steel bracket. The injection-molding machinery for producing the plastic housing is expensive, and Espelho Ltda. does not own such equipment. The plastic parts that Espelho requires are produced by Magnum in the United States and then shipped to Espelho as an intercompany sale. Prices must be established for these intercompany transfers. The transfer price generates sales revenue for Magnum and is a component of cost of goods sold for Espelho. If the transfer were being made within the United States, Magnum's management would allow the buyer and seller to negotiate a price that both would be willing to accept.

This intercompany sale is being made from one country to another. Because the income tax rate in Portugal is higher than that in the United States, Magnum requires these parts to be sold to Espelho at as high a price as possible. Transferring parts to Portugal at high prices shifts gross profit to the United States that otherwise would be earned in Portugal, thus reducing the total taxes paid to both countries. Most governments are aware that multinational companies have the ability to shift profits between countries through discretionary transfer pricing. To make sure that companies pay their fair share of local taxes, most countries have laws that regulate international transfer pricing. Magnum Corporation must be careful that, in transferring parts from the United States to Portugal, the transfer price is acceptable to tax authorities in both countries. The United States, especially, has become aggressive in enforcing its transfer pricing regulations.

Performance Evaluation of Foreign Operations

To ensure that operations in both the United States and Portugal are achieving their objectives, Magnum's top management requests that the managers of the various operating units submit periodic reports to headquarters detailing their unit's performance. Headquarters management is interested in evaluating the performance of the operating unit as well as the performance of the individuals responsible for managing those units. The process for evaluating performance that Magnum has used in the past for its U.S. operations is not directly transferable in evaluating the performance of Espelho Ltda. Several issues unique to foreign operations must be considered in designing the evaluation system. For example, Magnum has to decide whether to evaluate Espelho's performance on the basis of euros or U.S. dollars. Translation from one currency to another can affect return-on-investment ratios that are often used as performance measures. Magnum must also decide whether reported results should be adjusted to factor out those items over which Espelho's managers had no control, such as the inflated price paid for plastic parts imported from Magnum. There is no universally correct solution to the various issues that Magnum must address, and the company is likely to find it necessary to make periodic adjustments to its evaluation process for foreign operations.

International Auditing

The primary objective of Magnum's performance evaluation system is to maintain control over its decentralized operations. Another important component of the management control process is internal auditing. The internal auditor must (1) make sure that the company's policies and procedures are being followed and (2) uncover errors, inefficiencies, and, unfortunately at times, fraud. There are several issues that make the internal audit of a foreign operation more complicated than domestic audits.

Perhaps the most obvious obstacle to performing an effective internal audit is language. To be able to communicate with Espelho's managers and employees—asking the questions that need to be asked and understanding the answers—Magnum's internal auditors need to speak Portuguese. The auditors also need to be familiar with the local culture and customs, because these may affect the amount of work necessary in the audit. This familiarity can help to explain some of the behavior encountered and perhaps can be useful in planning the audit. Another important function of the internal auditor is to make sure that the company is in compliance with the Foreign Corrupt Practices Act, which prohibits a U.S. company from paying bribes to foreign government officials to obtain business. Magnum needs to make sure that internal controls are in place to provide reasonable assurance that illegal payments are not made.

External auditors encounter the same problems as internal auditors in dealing with the foreign operations of their clients. External auditors with multinational company clients must have an expertise in the various sets of financial accounting rules as well as the auditing standards in the various jurisdictions in which

EXHIBIT 1.2
The History of KPMG

Source: KPMG International, www.kpmgcampus.com/whoweare/history.shtml, accessed April 18, 2010.

KPMG was formed in 1987 through the merger of Peat Marwick International (PMI) and Klynveld Main Goerdeler (KMG). KPMG's history can be traced through the names of its principal founding members—whose initials form the name "K.P.M.G."

- **K** stands for Klynveld. Piet Klynveld founded the accounting firm Klynveld Kraayenhof & Co. in Amsterdam in 1917.
- **P** is for Peat. William Barclay Peat founded the accounting firm William Barclay Peat & Co. in London in 1870.
- **M** stands for Marwick. James Marwick founded the accounting firm Marwick, Mitchell & Co. with Roger Mitchell in New York City in 1897.
- **G** is for Goerdeler. Dr. Reinhard Goerdeler was for many years chairman of the German accounting firm Deutsche Treuhand-Gesellschaft.

In 1911, William Barclay Peat & Co. and Marwick Mitchell & Co. joined forces to form what would later be known as Peat Marwick International (PMI), a worldwide network of accounting and consulting firms.

In 1979, Klynveld joined forces with Deutsche Treuhand-Gesellschaft and the international professional services firm McLintock Main Lafrentz to form Klynveld Main Goerdeler (KMG).

In 1987, PMI and KMG and their member firms joined forces. Today, all member firms throughout the world carry the KPMG name exclusively or include it in their national firm names.

their clients operate. Magnum's external auditors, for example, must be capable of applying Portuguese auditing standards to attest that Espelho's financial statements present a true and fair view in accordance with Portuguese GAAP. In addition, they must apply U.S. auditing standards to verify that the reconciliation of Espelho's financial statements for consolidation purposes brings the financial statements in compliance with U.S. GAAP.

As firms have become more multinational, so have their external auditors. Today, the Big Four international accounting firms are among the most multinational organizations in the world. Indeed, one of the Big Four accounting firms, KPMG, is the result of a merger of four different accounting firms that originated in four different countries (see Exhibit 1.2) and currently has offices in more than 150 jurisdictions around the world.

Cross-Listing on Foreign Stock Exchanges

Magnum's investment in Portugal turned out to be extremely profitable, and over time the company established operations in other countries around the world. As each new country was added to the increasingly international company, Magnum had to address new problems associated with foreign GAAP conversion, foreign currency translation, international taxation and transfer pricing, and management control.

By the beginning of the 21st century, Magnum had become a truly global enterprise with more than 10,000 employees spread across 16 different countries. Although the United States remained its major market, the company generated less than half of its revenues in its home country. Magnum eventually decided that in addition to its stock being listed on the New York Stock Exchange (NYSE), there would be advantages to having the stock listed and traded on several foreign stock exchanges. Most stock exchanges require companies to file an annual report and specify the accounting rules that must be followed in preparing financial statements. Regulations pertaining to foreign companies can differ from those for domestic companies. For example, in the United States, the Securities and Exchange Commission requires all U.S. companies to use U.S. GAAP in preparing their financial statements. Foreign companies listed on U.S. stock exchanges may use foreign GAAP in preparing their financial statements but must provide a reconciliation of net income and stockholders' equity to U.S. GAAP. In 2007 the U.S. Securities and Exchange Commission relaxed this requirement for those companies that use International Financial Reporting Standards to prepare financial statements.

Many stock exchanges around the world now allow foreign companies to be listed on those exchanges by using standards developed by the International Accounting Standards Board (IASB). Magnum determined that by preparing a set of financial statements based on the IASB's International Financial Reporting Standards (IFRS), it could gain access to most of the stock exchanges it might possibly want to, including London's and Frankfurt's. With the help of its external auditing firm, Magnum's accountants developed a second set of financial statements prepared in accordance with IFRS and the company was able to obtain stock exchange listings in several foreign countries.

Global Accounting Standards

Through their experiences in analyzing the financial statements of potential acquisitions and in cross-listing the company's stock, Magnum's managers began to wonder whether the differences that exist in GAAP across countries were really necessary. There would be significant advantages if all countries, including the United States, were to adopt a common set of accounting rules. In that case, Magnum could use one set of accounting standards as the local GAAP in each of the countries in which it has operations and thus avoid the GAAP conversion that it currently must perform in preparing consolidated financial statements. A single set of accounting rules used worldwide also would significantly reduce the problems the company had experienced over the years in evaluating foreign investment opportunities based on financial statements prepared in compliance with a variety of local GAAP. Magnum Corporation became a strong proponent of global accounting standards.

THE GLOBAL ECONOMY

Although Magnum is a fictitious company, its evolution into a multinational corporation is not unrealistic. Most companies begin by selling their products in the domestic market. As foreign demand for the company's product arises, this demand is met initially through making export sales. Exporting is the entry point for most companies into the world of international business.

International Trade

International trade (imports and exports) constitutes a significant portion of the world economy. In 2008, companies worldwide exported more than $16.0 trillion worth of merchandise.[5] The three largest exporters were Germany, China, and the United States, in that order. The United States, Germany, and China, in that order, were the three largest importers. Although international trade has existed for thousands of years, recent growth in trade has been phenomenal. Over the

[5] World Trade Organization, *International Trade Statistics 2009,* Table I.8, Leading Exporters and Importers in World Merchandise Trade, 2008.

period 1996–2008, U.S. exports increased from $625 billion to $1,287 billion per year, a 106 percent increase. During the same period, Chinese exports increased sixfold to $1,428 billion in 2008. Manufactured products account for 66.5 percent of world trade, followed by fuel and mining products (22.5 percent) and agricultural products (8.5 percent).[6]

The number of companies involved in trade also has grown substantially. The number of U.S. companies making export sales rose by 233 percent from 1987 to 1999, when the number stood at 231,420.[7] Boeing is a U.S.-based company with billions of dollars of annual export sales. In 2009, 42 percent of the company's sales were outside of the United States. In addition, some of the company's key suppliers and subcontractors are located in Europe and Japan. However, not only large companies are involved in exporting. Companies with fewer than 500 workers comprise more than 90 percent of U.S. exporters.

Foreign Direct Investment

The product cycle theory suggests that, as time passes, exporters may feel the only way to retain their advantage over competition in foreign markets is to produce locally, thereby reducing transportation costs. Companies often acquire existing operations in foreign countries as a way to establish a local production capability. Alternatively, companies can establish a local presence by founding a new company specifically tailored to the company's needs. Sometimes this is done through a joint venture with a local partner.

The acquisition of existing foreign companies and the creation of new foreign subsidiaries are the two most common forms of what is known as foreign direct investment (FDI). The growth in FDI can be seen in Exhibit 1.3. The tremendous increase in the flow of FDI from 1982 to 2007 is partially attributable to the liberalization of investment laws in many countries specifically aimed at attracting FDI. Of 244 changes in national FDI laws in 2003, 220 were more favorable for foreign investors.[8]

FDI is playing a larger and more important role in the world economy. Global sales of foreign affiliates were about 1.5 times as high as global exports in 2008, compared to almost parity in 1982. Global sales of foreign affiliates comprises about 10 percent of worldwide gross domestic product.

In 2008, there were 73 cross-border acquisitions of existing companies in which the purchase price exceeded $3 billion. The largest deal was the acquisition of the U.S. firm Anheuser-Busch Cos. Inc. by InBev NV, a Belgium-based company, for a reported $52.2 billion. More than 6,000 FDI greenfield and expansion projects were announced in 2005 at an estimated cost of $716 billion.[9] The United Kingdom was the leading location of these projects, followed by the United States, and Germany.

After years of steady increases, inflows of FDI within the countries of the Organization for Economic Cooperation and Development (OECD) reached a peak of $1.2 trillion in 2000, dropping to $622 billion in 2005.[10] The most popular locations for inbound FDI in 2005 among OECD countries were, in order of importance, the

[6] Ibid., Table II.1, World Merchandise Exports by Product, 2008.

[7] U.S. Department of Commerce, International Trade Administration, "Small and Medium-Sized Enterprises Play an Important Role," *Export America,* September 2001, pp. 26–29.

[8] United Nations, *World Investment Report 2004,* p. xvii.

[9] Ibid., p. 6.

[10] Organization for Economic Cooperation and Development, "Trends and Recent Developments in Foreign Direct Investment," *International Investment Perspectives,* 2006, p. 13.

EXHIBIT 1.3
Growth in Foreign Direct Investment, 1982–2008

Source: United Nations, *World Investment Report 2009,* Table I.6.

Item	Value ($ billions) 1982	1990	2007	2008
FDI inflows	$ 58	$ 207	$ 1,979	$ 1,697
FDI outflows	27	239	2,147	1,858
FDI inward stock	790	1,942	15,660	14,909
FDI outward stock	579	1,786	16,227	16,206
Sales of foreign affiliates	2,530	6,026	31,764	30,311
Assets of foreign affiliates	2,036	5,938	73,457	69,771
Employment by foreign affiliates (thousands)	19,864	24,476	80,396	77,386

United Kingdom, the United States, France, Luxembourg, and The Netherlands. The countries with the largest dollar amount of outbound FDI in 2005 were The Netherlands, France, the United Kingdom, Luxembourg, and Japan.

The extent of foreign corporate presence in a country can be viewed by looking at the cumulative amount of inward FDI. Over the period 1996–2005, the United States received more FDI ($1.54 trillion) than any other OECD country.[11] The United States also had the largest amount of outbound FDI ($1.41 trillion) during this period.

Multinational Corporations

A multinational corporation is a company that is headquartered in one country but has operations in other countries.[12] The United Nations estimates that there are more than 82,000 multinational companies in the world, with more than 810,000 foreign affiliates.[13] The 100 largest multinational companies account for approximately 4 percent of the world's GDP.[14]

Companies located in a relatively small number of countries conduct a large proportion of international trade and investment. These countries—collectively known as the triad—are the United States, Japan, and members of the European Union. As Exhibit 1.4 shows, 83 of the 100 largest companies in the world are located in the triad.

The largest companies are not necessarily the most multinational. Of the 500 largest companies in the United States in 2000, for example, 36 percent had no foreign operations.[15] In 2008 the United Nations measured the multinationality of companies by averaging three factors: the ratio of foreign sales to total sales, the ratio of foreign assets to total assets, and the ratio of foreign employees to total employees. Exhibit 1.5 lists the top 10 companies according to this measure.

[11] Ibid., p. 21.

[12] There is no universally accepted definition of a multinational corporation. The definition used here comes from Alan M. Rugman and Richard M. Hodgetts, *International Business: A Strategic Management Approach* (New York: McGraw-Hill, 1995, p. 3). Similarly, the United Nations defines *multinational corporations* as "enterprises which own or control production or service facilities outside the country in which they are based" (United Nations, *Multinational Corporations in World Development,* 1973, p. 23), and defines *transnational corporations* as "enterprises comprising parent companies and their foreign affiliates" (United Nations, *World Investment Report 2001,* p. 275).

[13] United Nations, *World Investment Report 2009,* p. 17.

[14] Ibid.

[15] T. Doupnik and L. Seese, "Geographic Area Disclosures under SFAS 131: Materiality and Fineness," *Journal of International Accounting, Auditing & Taxation,* 2001, pp. 117–38.

EXHIBIT 1.4
Home Country of Largest 100 Companies by Sales

Source: *Fortune*, "The 2009 Global 500," July 20, 2009.

United States	29	Japan	10
European Union		**Other**	
Germany	15	China	5
France	10	South Korea	4
United Kingdom	6	Russia	2
Italy	5	Brazil	1
Spain	3	Mexico	1
Netherlands	2	Norway	1
Belgium	1	Malaysia	1
Finland	1	Venezuela	1
Luxembourg	1	Switzerland	1
	44		17

Xstrata Plc was the most multinational company in the world, with more than 90 percent of its assets, sales, and employees located outside its home country of the United Kingdom. One-half the companies on this list come from the United Kingdom. The five most multinational U.S. companies in 2008, in order, were AES Corporation, Liberty Group Inc., Coca-Cola, ExxonMobil, and Procter & Gamble.

Many companies have established a worldwide presence. Nike Inc., the world's largest manufacturer of athletic footwear, apparel, and equipment, has branch offices and subsidiaries in 52 countries, sells products in more than 170 countries, and has more than 34,000 employees around the globe. Virtually all of Nike's footwear and apparel products are manufactured outside of the United States. The company generates approximately 58 percent of its sales outside the United States.[16]

Nokia, the Finnish cellular telephone manufacturer, has 10 manufacturing facilities in nine different countries around the world, including South Korea, Brazil, China, and the United States. Because these subsidiaries are outside of the euro zone, Nokia must translate the financial statements from these operations

EXHIBIT 1.5 **The World's Top 10 Nonfinancial Companies in Terms of Multinationality, 2008**

Source: United Nations, *World Investment Report 2009*, pp. 228–230.

Corporation	Country	Industry	MNI*
Xstrata Plc	United Kingdom	Mining and quarrying	93.2
ArcelorMittal	Luxembourg	Metals and metal products	91.4
AkzoNobel	Netherlands	Pharmaceuticals	90.3
WPP Group Plc	United Kingdom	Other business services	88.9
Vodafone Group Plc	United Kingdom	Telecommunications	88.6
Nokia	Finland	Telecommunications	88.5
Linde AG	Germany	Chemicals	88.3
Anglo American	United Kingdom	Mining and quarrying	87.5
InBev SA	Netherlands	Food, beverages, and tobacco	87.0
AstraZeneca Plc	United Kingdom	Pharmaceuticals	86.8

*Multinationality index (MNI) is calculated as the average of three ratios: foreign assets/total assets, foreign sales/total sales, and foreign employment/total employment.

[16] Nike Inc., 2009 Form 10-K, various pages.

into euros for consolidation purposes. Nokia's management states that, from time to time, it uses forward contracts and foreign currency loans to hedge the foreign exchange risk created by foreign net investments.[17]

International Capital Markets

Many multinational corporations have found it necessary, for one reason or another, to have their stock cross-listed on foreign stock exchanges. Large companies in small countries, such as Finland's Nokia, might find this necessary to obtain sufficient capital at a reasonable cost. Nokia's shares are listed on the Helsinki, Stockholm, Frankfurt, and New York stock exchanges. Other companies obtain a listing on a foreign exchange to have an "acquisition currency" for acquiring firms in that country through stock swaps. Not long after obtaining a New York Stock Exchange (NYSE) listing, Germany's Daimler-Benz acquired Chrysler in the United States in an exchange of shares.

As of January 31, 2010, there were 499 foreign companies from 47 countries cross-listed on the NYSE.[18] During 2007, 63.8 billion shares of stock in these companies were traded. The total market value of these companies' NYSE shares at the end of 2007 was $1.6 trillion. Most of these companies were required to reconcile their local GAAP financial statements to a U.S. GAAP basis.

Many U.S. companies are similarly cross-listed on non-U.S. stock exchanges. For example, more than 50 U.S. companies are listed on the London Stock Exchange, including Abbott Labs, Boeing, and Pfizer. U.S. companies such as Caterpillar, Intel, and Pepsico are listed on Euronext, a merger of the Amsterdam, Brussels, and Paris stock exchanges.

OUTLINE OF THE BOOK

The evolution of the fictitious Magnum Corporation presented earlier in this chapter highlights many of the major accounting issues that a multinational corporation must address and that form the focus for this book. The remainder of this book is organized as follows.

Chapters 2 and 3 focus on differences in financial reporting across countries and the international convergence of accounting standards. Chapter 2 provides evidence of the diversity in financial reporting that has existed internationally, explores the reasons for that diversity, and describes the various attempts to classify countries by accounting system. Chapter 3 describes and evaluates the major efforts to converge accounting internationally. The most important player in the development of global financial reporting standards is the International Accounting Standards Board (IASB). Chapter 3 describes the work of the IASB and introduces International Financial Reporting Standards (IFRS).

Chapters 4 and 5 describe and demonstrate the requirements of selected IASB standards through numerical examples. In addition to describing the guidance provided by IFRS, these chapters provide comparisons with U.S. GAAP to indicate the differences and similarities between the two sets of standards. Chapter 4 focuses on IFRS related to the recognition and measurement of assets, specifically inventories, property, plant and equipment, intangibles and goodwill, and leased assets. IFRS that deal exclusively with disclosure and presentation issues also are briefly summarized. Chapter 5 covers IFRS related to current liabilities,

[17] Nokia Corporation, 2009 Form 20-F, various pages.

[18] New York Stock Exchange, www.nyse.com/pdfs/Non-US_CurListofallStocks01-01-10.pdf.

provisions, employee benefits, share-based payment, income taxes, revenue, and financial instruments.

Chapter 6 describes the accounting environment in five economically significant countries—China, Germany, Japan, Mexico, and the United Kingdom—that are representative of major clusters of accounting system.

Chapters 7–9 focus on financial reporting issues that are of international significance either because they relate to international business operations or because there is considerable diversity in how they are handled worldwide. Chapters 7 and 8 deal with issues related to foreign currency translation. Chapter 7 covers the accounting for foreign currency transactions and hedging activities, and Chapter 8 demonstrates the translation of foreign currency financial statements. Chapter 9 covers several other important financial reporting issues, specifically inflation accounting, business combinations and consolidated financial statements, and segment reporting. This chapter focuses on IFRS related to these topics.

Chapter 10 introduces issues related to the analysis of foreign financial statements and explores potential problems (and potential solutions) associated with using the financial statements of foreign companies in decision making. This chapter also provides an example of how an analyst would reformat and restate financial statements from one set of GAAP to another.

International taxation and international transfer pricing are covered in Chapters 11 and 12. Chapter 11 focuses on the taxation of foreign operation income by the home country government. Much of this chapter deals with foreign tax credits, the most important mechanism available to companies to reduce double taxation. Chapter 12 covers the topic of international transfer pricing, focusing on tax implications.

Strategic accounting issues of particular relevance to multinational corporations are covered in Chapter 13. This chapter covers multinational capital budgeting as a vital component of strategy formulation and operational budgeting a key ingredient in strategy implementation. Chapter 13 also deals with issues that must be addressed in designing a process for evaluating the performance of foreign operations.

Chapter 14 covers comparative international auditing and corporate governance. This chapter discusses both external and internal auditing issues as they relate to corporate governance in an international context. Chapter 14 also describes international diversity in external auditing and the international harmonization of auditing standards. In addition to financial reports, more than 1,000 multinational companies worldwide publish a separate sustainability report, which provides environmental, social responsibility, and related disclosures. Chapter 15 introduces corporate social responsibility and sustainability reporting.

Summary

1. International accounting is an extremely broad topic. At a minimum, it focuses on the accounting issues unique to multinational corporations. At the other extreme, it includes the study of the various functional areas of accounting (financial, managerial, auditing, tax, information systems) in all countries of the world, as well as a comparison across countries. This book provides an overview of the broadly defined area of international accounting, with a focus on the accounting issues encountered by multinational companies engaged in international trade and making foreign direct investments.
2. The world economy is becoming increasingly more integrated. International trade (imports and exports) has grown substantially in recent years and is even

becoming a normal part of business for relatively small companies. The number of U.S. exporting companies more than doubled in the 1990s.

3. The tremendous growth in foreign direct investment (FDI) over the last two decades is partially attributable to the liberalization of investment laws in many countries specifically aimed at attracting FDI. The aggregate revenues generated by foreign operations outstrip the revenues generated through exporting by a two-to-one margin.
4. There are more than 82,000 multinational companies in the world, and their 810,000 foreign subsidiaries generate approximately 10 percent of global gross domestic product (GDP). A disproportionate number of multinational corporations are headquartered in the triad: the United States, Japan, and the European Union.
5. The largest companies in the world are not necessarily the most multinational. Indeed, many large U.S. companies have no foreign operations. According to the United Nations, the two most multinational companies in the world in 2008 were located in the United Kingdom and Luxembourg.
6. In addition to establishing operations overseas, many companies also cross-list their shares on stock exchanges outside of their home country. There are a number of reasons for doing this, including gaining access to a larger pool of capital.
7. The remainder of this book consists of 14 chapters. Nine chapters (Chapters 2–10) deal primarily with financial accounting and reporting issues, including the analysis of foreign financial statements. Chapters 11 and 12 focus on international taxation and transfer pricing. Chapter 13 deals with the management accounting issues relevant to multinational corporations in formulating and implementing strategy. Chapter 14, covers comparative international auditing and corporate governance. The final chapter, Chapter 15, provides an introduction to social responsibility reporting at the international level.

Questions

1. How important is international trade (imports and exports) to the world economy?
2. What accounting issues arise for a company as a result of engaging in international trade (imports and exports)?
3. Why might a company be interested in investing in an operation in a foreign country (foreign direct investment)?
4. How important is foreign direct investment to the world economy?
5. What financial reporting issues arise as a result of making a foreign direct investment?
6. What taxation issues arise as a result of making a foreign direct investment?
7. What are some of the issues that arise in evaluating and maintaining control over foreign operations?
8. Why might a company want its stock listed on a stock exchange outside of its home country?
9. Where might one find information that could be used to measure the "multinationality" of a company?
10. What would be the advantages of having a single set of accounting standards used worldwide?

Exercises and Problems

1. Sony Corporation reported the following in the summary of Significant Accounting Policies included in the company's 2009 annual report on Form 20-F (p. F-16):

   Translation of Foreign Currencies

   All asset and liability accounts of foreign subsidiaries and affiliates are translated into Japanese yen at approximate year-end current exchange rates and all income and expense accounts are translated at exchange rates that approximate those rates prevailing at the time of the transactions. The resulting translation adjustments are accumulated as a component of accumulated other comprehensive income.

   Receivables and payables denominated in foreign currency are translated at appropriate year-end exchange rates and the resulting translation gains or losses are taken into income.

   Required:

   Explain in your own words the policies that Sony uses in reflecting in the financial statements the impact of changes in foreign exchange rates.

2. Sony Corporation reported the following in the Notes to Consolidated Financial Statements included in the company's 2009 annual report on Form 20-F (p. F-44):

   Foreign Exchange Forward Contracts and Foreign Currency Option Contracts

   Foreign exchange forward contracts and purchased and written foreign currency option contracts are utilized primarily to limit the exposure affected by changes in foreign currency exchange rates on cash flows generated by anticipated intercompany transactions and intercompany accounts receivable and payable denominated in foreign currencies.

   Sony also enters into foreign exchange forward contracts, which effectively fix the cash flows from foreign currency denominated debt.

   Required:

   Explain in your own words why Sony has entered into foreign exchange forward contracts and foreign currency option contracts.

3. Cooper Grant is the president of Acme Brush of Brazil the wholly owned Brazilian subsidiary of U.S.-based Acme Brush Inc. Cooper Grant's compensation package consists of a combination of salary and bonus. His annual bonus is calculated as a predetermined percentage of the pretax annual income earned by Acme Brush of Brazil. A condensed income statement for Acme Brush of Brazil for the most recent year is as follows (amounts in thousands of Brazilian reals [BRL]):

Sales	BRL10,000
Expenses	9,500
Pretax income	BRL 500

   After translating the Brazilian real income statement into U.S. dollars, the condensed income statement for Acme Brush of Brazil appears as follows (amounts in thousands of U.S. dollars [US$]):

Sales	US$3,000
Expenses	3,300
Pretax income (loss)	US$ (300)

Required:

a. Explain how Acme Brush of Brazil's pretax income (in BRL) became a U.S.-dollar pretax loss.

b. Discuss whether Cooper Grant should be paid a bonus or not.

4. The New York Stock Exchange (NYSE) provides a list of non-U.S. companies listed on the exchange on its Web site (www.nyse.com). (Hint: Search the internet for "NYSE List of Non-U.S. Listed Issuers.")

Required:

a. Determine the number of foreign companies listed on the NYSE and the number of countries they represent.

b. Determine the five countries with the largest number of foreign companies listed on the NYSE.

c. Speculate as to why non-U.S. companies have gone to the effort to have their shares listed on the NYSE.

5. The London Stock Exchange (LSE) provides a list of companies listed on the exchange on its Web site (www.londonstockexchange.com) under "Statistics" and "List of Companies."

Required:

a. Determine the number of foreign companies listed on the LSE and the number of countries they represent.

b. Determine the number of companies listed on the LSE from these countries: Australia, Brazil, Canada, France, Germany, Mexico, and the United States. Speculate as to why there are more companies listed on the LSE from Australia and Canada than from France and Germany.

6. AstraZeneca PLC and Tesco PLC are two of the largest companies in the United Kingdom. The following information was provided in each company's 2009 annual report.

ASTRAZENECA
Annual Report 2009

Geographic Areas	Sales ($ million)	Total Assets ($ million)
United Kingdom	10,865	17,092
Continental Europe	13,820	6,706
The Americas	19,257	28,397
Asia, Africa, & Australasia	4,904	2,725

TESCO
Annual Report 2009

Geographical Segments	Sales (£ million)	Segment Assets (£ million)
United Kingdom	38,191	29,913
Rest of Europe	8,862	6,953
Asia	7,068	6,242
United States	206	768
Unallocated	-0-	2,115

Required:

Calculate an index of multinationality based upon the geographical distribution of Sales and Assets (employee information is not available) to determine which of these two companies is more multinational.

Case 1-1

Besserbrau AG

Besserbrau AG is a German beer producer headquartered in Ergersheim, Bavaria. The company, which was founded in 1842 by brothers Hans and Franz Besser, is publicly traded with shares listed on the Frankfurt Stock Exchange. Manufacturing in strict accordance with the almost 500-year-old German Beer Purity Law, Besserbrau uses only four ingredients in making its products: malt, hops, yeast, and water. While the other ingredients are obtained locally, Besserbrau imports hops from a company located in the Czech Republic. Czech hops are considered to be among the world's finest. Historically, Besserbrau's products were marketed exclusively in Germany. To take advantage of a potentially enormous market for its products and expand sales, Besserbrau began making sales in the People's Republic of China three years ago. The company established a wholly owned subsidiary in China (BB Pijio) to handle the distribution of Besserbrau products in that country. In the most recent year, sales to BB Pijio accounted for 20 percent of Besserbrau's sales, and BB Pijio's sales to customers in China accounted for 10 percent of the Besserbrau Group's total profits. In fact, sales of Besserbrau products in China have expanded so rapidly and the potential for continued sales growth is so great that the company recently broke ground on the construction of a brewery in Shanghai, China. To finance construction of the new facility, Besserbrau negotiated a listing of its shares on the London Stock Exchange to facilitate an initial public offering of new shares of stock.

Required:

Discuss the various international accounting issues confronted by Besserbrau AG.

Case 1-2

Vanguard International Growth Fund

The Vanguard Group is an investment firm with more than 50 different mutual funds in which the public may invest. Among these funds are 13 international funds that concentrate on investments in non-U.S. stocks and bonds. One of these is the International Growth Fund. The following information about this fund was provided in the fund's prospectus, dated December 28, 2009.

VANGUARD INTERNATIONAL GROWTH FUND

Excerpts from Prospectus
December 28, 2009

Vanguard Fund Summary

Investment Objective

The Fund seeks to provide long-term capital appreciation.

Primary Investment Strategies

The Fund invests predominantly in the stocks of companies located outside the United States and is expected to diversify its assets across developed and emerging markets in Europe, the Far East, and Latin America. In selecting stocks, the Fund's advisors evaluate foreign markets around the world and choose large-, mid-, and small-capitalization companies considered to have above-average growth potential. The Fund uses multiple investment advisors.

Market Exposure

The Fund invests mainly in common stocks of non-U.S. companies that are considered to have above-average potential for growth. The asset-weighted median market capitalization of the Fund as of August 31, 2009, was $34.7 billion.

The Fund is subject to investment style risk, which is the chance that returns from non-U.S. growth stocks and, to the extent that the Fund is invested in them, small- and mid-cap stocks, will trail returns from the overall domestic stock market. Historically, small- and mid-cap stocks have been more volatile in price than the large-cap stocks that dominate the overall market, and they often perform quite differently.

The Fund is subject to stock market risk, which is the chance that stock prices overall will decline. Stock markets tend to move in cycles, with periods of rising prices and periods of falling prices. In addition, investments in foreign stock markets can be riskier than U.S. stock investments. The prices of foreign stocks and the prices of U.S. stocks have, at times, moved in opposite directions.

The Fund is subject to country/regional risk and currency risk. *Country/regional risk* is the chance that domestic events—such as political upheaval, financial troubles, or natural disasters—will adversely affect the value of securities issued by companies in foreign countries or regions. Because the Fund may invest a large portion of its assets in securities of companies located in any one country or region, its performance may be hurt disproportionately by the poor performance of its investments in that area. Country/regional risk is especially high in emerging markets. *Currency risk* is the chance that the value of a foreign investment, measured in U.S. dollars, will decrease because of unfavorable changes in currency exchange rates.

The Fund is subject to manager risk, which is the chance that poor security selection or focus on securities in a particular sector, category, or group of companies will cause the Fund to underperform relevant benchmarks or other funds with a similar investment objective.

PLAIN TALK ABOUT
International Investing

U.S. investors who invest abroad will encounter risks not typically associated with U.S. companies, because foreign stock and bond markets operate differently from the U.S. markets. For instance, foreign companies are not subject to the same accounting, auditing, and financial-reporting standards and practices as U.S. companies, and their stocks may not be as liquid as those of similar U.S. firms. In addition, foreign stock exchanges, brokers, and companies generally have less government supervision and regulation than their counterparts in the United States. These factors, among others, could negatively affect the returns U.S. investors receive from foreign investments.

Source: Vanguard International Growth Fund Prospectus, pp. 1–11

The International Growth Fund's annual report for the year ended August 31, 2009, indicated that 94 percent of the fund's portfolio was invested in 177 non-U.S. stocks and 6 percent was in temporary cash investments. The allocation of fund net assets by region was as follows: Europe 54 percent, Pacific 24 percent, Emerging Markets 20 percent, and Canada 1 percent. The sectors and individual countries in which the fund was invested are presented in the following tables:

Sector Diversification (% of equity exposure)	
Consumer discretionary	12.5%
Consumer staples	12.5
Energy	8.7
Financials	22.7
Health care	7.2
Industrials	11.9
Information technology	8.9
Materials	9.0
Telecommunication services	4.8
Utilities	1.8

Source: Annual report, p. 14.

Country Diversification (% of equity exposure)			
Europe		**Pacific**	
United Kingdom	17.2%	Japan	15.4%
France	10.0	Hong Kong	4.2
Switzerland	8.4	Australia	3.4
Germany	6.9	Singapore	1.3
Spain	3.5	Subtotal	24.3%
Sweden	2.8	**Emerging Markets**	
Netherlands	2.3	Brazil	6.4%
Denmark	1.8	China	5.4
Other European		Israel	2.3
Markets	1.5	Mexico	1.2
Subtotal	54.4%	South Africa	1.1
		Other Emerging	
		Markets	3.7
		Subtotal	20.1%
		North America	
		Canada	1.2%

Source: Annual report, p. 15.

Required:

1. Explain why an individual investor might want to invest in an international growth fund.
2. Describe the risks associated with making an investment in an international growth fund. Identify the risks that would be common to domestic and international funds, and those risks that would be unique to an international fund.
3. Discuss how the fact that foreign companies are not subject to the same accounting, auditing, and financial reporting standards and practices as U.S. companies poses a risk not typically encountered when investing in the stock of U.S. companies.
4. Consider the allocation of fund assets by region. Speculate as to why the proportions of fund assets are distributed in this manner.
5. Consider the country diversification of fund assets. Identify the countries in which the fund is most heavily invested. Speculate as to why this might be the case. Are there any countries in which you would have expected the fund to be more heavily invested than it is? Are there any countries in which you would have expected the fund to be invested and it is not?
6. Consider the sector diversification of funds assets. Identify the sectors in which the fund is most heavily invested. Speculate as to why this might be the case.

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