

EASTERN UNIVERSITY, SRI LANKA
FACULTY OF COMMERCE AND MANAGEMENT
FINAL YEAR - FIRST SEMESTER EXAMINATION IN BACHELOR OF COMMERCE
(SPECIALIZATION IN ACCOUNTING AND FINANCE) 2014 / 2015 (MAY 2017)

(PROPER/ REPEAT)

DAF 4033 INTERNATIONAL ACCOUNTING

Answer all questions

Time: 03 Hours

01. i. Z Company, a U.S.-based importer of specialty olive oil, placed an order with a foreign supplier for 500 cases of olive oil at a price of 100 Franc per case. The total purchase price is 50,000 Franc. Exchange rates for Franc in US dollar are as follows:

Date	Spot Rate	Forward Rate (to January 31, 2017)
December 1, 2016	\$1.00	\$1.08
December 31, 2016	1.10	1.17
January 31, 2017	1.15	1.15

Z Company closes the books and prepares financial statements on December 31.

Required:

Assume the olive oil was received on December 1, 2016, and payment was made on January 31, 2017. There was no attempt to hedge the exposure to foreign exchange risk. Prepare journal entries to account for this import purchase.

(05 Marks)

- ii. Multico (a U.S.-based company) forms a wholly owned subsidiary in Italy (Italco) on December 31, 2015. On that date, Multico invests \$1,000,000 in exchange for all of the subsidiary's capital stock. Given the exchange rate of €1.00 = \$1.00, the initial capital investment is €1,000,000, of which €600,000 is immediately invested in inventory and the remainder is held in cash. Thus, Italco begins operations on January 1, 2016 with stockholders' equity (net assets) of €1,000,000 and net monetary assets of €400,000. Italco's beginning balance sheet on January 1, 2016 is shown below.

ITALCO
Beginning Statement of Financial Position
January 1, 2016

Assets	€	Liabilities and Equity	€
Cash	400,000	Capital stock	1,000,000
Inventory	<u>600,000</u>		
	<u>1,000,000</u>		<u>1,000,000</u>

During 2016, Italco purchased property and equipment, acquired a patent, and additional purchases of inventory, primarily on account. A five-year loan was repaid to help finance the purchase of equipment. Sales were made, primarily on account, and expenses were incurred. Income after taxes of €825,000 was generated, with dividends of €325,000 declared on December 1, 2016.

Financial statements for 2016 (in euros) are as follows.

Income Statement
2016

	€
Sales	8,000,000
Cost of goods sold	6,000,000
Gross profit	2,000,000
Selling and administrative expenses	500,000
Depreciation expense	200,000
Amortization expense	20,000
Interest expense	180,000
Income before income taxes	1,100,000
Income taxes	275,000
Net income	825,000

Statement of Retained Earnings
2016

	€
Retained earnings, 1/1/2016	0
Net income, 2016	825,000
Less: Dividends, 1/12/2016	<u>(325,000)</u>
Retained earnings, 31/12/2016	<u>500,000</u>

Statement of Financial Position

December 31, 2016

Assets	€	Liabilities and Equity	€
Cash	550,000	Accounts payable	<u>330,000</u>
Accounts receivable	600,000	Total current liabilities	330,000
Inventory*	<u>800,000</u>	Long-term debt	<u>2,000,000</u>
Total current assets	1,950,000	Total liabilities	2,330,000
Property and equipment	2,000,000	Capital stock	1,000,000
Less: Accumulated depreciation	(200,000)	Retained earnings	500,000
Patents, net	<u>80,000</u>		
Total assets	<u>3,830,000</u>	Total Liabilities and Equity	<u>3,830,000</u>

* Inventory is carried at first-in, first-out (FIFO) cost; ending inventory was acquired evenly throughout the month of December.

Relevant exchange rates are as follows:

January 1, 2016	\$1.00
Rate when property and equipment were acquired and long-term debt was incurred, January 15, 2016	0.98
Rate when patent was acquired, February 1, 2016	0.97
Average 2016	0.95
Rate when dividends were declared, December 1, 2016	0.92
Average for the month of December	0.91
December 31, 2016	0.90

Required:

a. Translate Financial Statements of Itarco into US dollar by applying Current Rate Method.

(07 Marks)

b. Translate Financial Statements of Itarco into US dollar by applying Temporal Method.

(08 Marks)

(Total 20 Marks)

02. i. What is a financial future contract? How does it differ from a forward exchange contract?
- ii. What are the four main steps in doing a business strategy analysis using financial statements? Why, at each step, is analysis in a cross-border context more difficult than a single-country analysis?
- iii. As an employee on the financial staff of Multinational Enterprises, you are assigned to a three-person team that is assigned to examine the financial feasibility of establishing a wholly owned manufacturing subsidiary in the Czech Republic. You are to determine an appropriate hurdle (discount) rate with which to conduct a discounted cash flow analysis. List all the parameters you would consider in measuring your company's cost of capital (discount rate).
- iv. Bay City Rollers Inc., a U.S. company, has a branch located in Sao Antonio and another in the Bahian Islands. The foreign source income from the Sao Antonio branch is \$150,000, and the foreign source income from the Bahian Island branch is \$200,000. The corporate tax rates in Sao Antonio, the Bahian Islands, and the United States are 30 percent, 24 percent, and 35 percent, respectively.

Required:

Determine Bay City Rollers' (a) U.S. foreign tax credit and (b) net U.S. tax liability related to these foreign sources of income.

03. i. Sorocaba Company is located in a highly inflationary country and in accordance with IAS 29 prepares financial statements on a general purchasing power (inflation-adjusted) basis through reference to changes in the general price index (GPI). The company reports the following transactions involving machinery and equipment in its first two years of operations:

Date	Transaction	Cost	Useful Life	GPI
January 15, 2015	Purchase Machine X	\$ 20,000	4 years	100
March 20, 2015	Purchase Machine Y	\$ 55,000	5 years	110
October 10, 2015	Purchase Machine Z	\$ 130,000	10 years	130
December 31, 2015				140
April 15, 2016	Sold Machine X			150
December 31, 2016				160

Required:

Determine the amount that would be reported as machinery and equipment in accordance with IAS 29 on the December 31, 2015, and December 31, 2016, in the balance sheets of the company.

(07 Marks)

- ii. Doner Company Inc. begins operations on January 1, 2016. The company's unadjusted financial statements for the year ended December 31, 2016, appear as follows:

Balance Sheets

Assets/ Liabilities	1/1/2016	31/12/2016
Cash and receivables	\$20,000	\$35,000
Fixed assets, net	\$50,000	\$45,000
Total	\$70,000	\$80,000
Payables	\$15,000	\$15,000
Contributed capital	\$55,000	\$55,000
Retained earnings	—	\$10,000
Total	\$70,000	\$80,000

Income Statement, 2016

Revenues	\$50,000
Depreciation	\$ (5,000)
Other expenses	\$ (35,000)
Income	\$10,000

Revenues and expenses occur evenly throughout the year; revenues and other expenses are realized in terms of monetary assets (cash and receivables).

General price indexes for 2016 are as follows:

1/1/2016	100
Average 2016	120
31/12/2016	150

Required:

- a. Calculate Doner Company's 2016 purchasing power gain or loss on net monetary items.

(04 Marks)

- b. Determine Doner Company's 2016 income on a general purchasing power basis (ignore income taxes).

(04 Marks)

- iii. Describe IOSCO's work on harmonizing disclosure standards for cross-border and initial listings by foreign issuers. Why is this work important to securities markets around the world?

(06)
(Total 20)

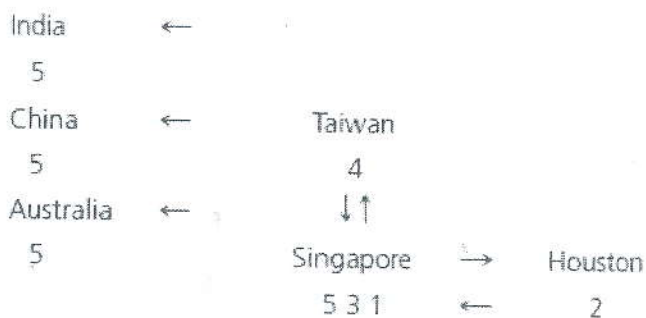
04. i. Accounting may be viewed as having three components: measurement, disclosure, and auditing. What are the advantages and disadvantages of this classification? Can you suggest alternative classifications that might be useful?

(05)

- ii. What contemporary factors are contributing to the internationalization of the accounting profession?

(05)

- iii. Outsourcing process for Hewlett-Packard's (HP's) production of the Proliant ML150 is described below.



H-P's Path to Market

1. Idea for ML150 spawned in Singapore
2. Concept approved in Houston
3. Concept design performed in Singapore
4. Engineering design and initial manufacture in Taiwan
5. Final assembly in Australia, China, India, and Singapore. Machines produced in Australia, China, and India sold in local markets; machines assembled in Singapore marketed in Southeast Asia.

Figure: Outsourcing process for Hewlett-Packard's Proliant ML150

Required:

Identify the various accounting and related issues that might arise in each step of the production chain of HP.

(06)

iv. Are national differences in accounting practice better explained by culture or by economic and legal factors? Why?

(05 Marks)

(Total 20 Marks)

i. What are the major accounting classifications in the world? What are the distinguishing features of each model?

(05 Marks)

ii. China's aim is to develop accounting standards that are harmonized with international practices. What examples are there that Chinese accounting standards are consistent with "world class" practices?

(05 Marks)

iii. What is the Global Reporting Initiative?

(05 Marks)

vi. What motivates firms in many countries to engage in Corporate Social Reporting (CSR) practices?

(05 Marks)

(Total 20 Marks)