

# TRANS GLOBAL CORPORATION

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## Abstract

*Trans-Global Corporation is a multinational company facing a complex set of inter-related problems. The case provides the opportunity for the student to gain experience in eight areas of multinational accounting:*

- *International Financial Reporting Standards*
- *Impact of a country's EU status on that country's accounting standards*
- *Making decisions on the appropriate functional currency*
- *Selecting the appropriate currency translation method*
- *Preparation of financial statement translations*
- *Analyzing exchange rates*
- *Analyzing gains and losses on currency transactions*
- *Accounting impact of using derivatives to hedge against losses on currency transactions*

*With the new Sarbanes-Oxley requirement that the CEO and CFO must certify the effectiveness of the internal controls, Trans-Global is faced with determining whether its internal controls in the multinational accounting area are adequate.*

## Case Objectives

1. Give the student experience in analyzing the differences between U.S. Financial Accounting Standards and International Financial Reporting Standards.
2. Give the student experience in understanding the different status of countries' acceptance to the European Union and the impact that this status has on the countries' flexibility in choosing accounting standards.
3. Give the student experience in making decisions on the appropriate functional currency to use.
4. Give the student experience in selecting the appropriate currency translation method.
5. Give the student experience in preparing financial statement translations.
6. Give the student experience in analyzing current exchange rates, exchange rates at the financial statement date, and historical exchange rates.
7. Give the student experience in analyzing gains and losses on currency transactions.
8. Give the student experience in analyzing the accounting impact of using derivatives to hedge against losses on currency transactions.

## The Parent Company

Trans-Global Corporation is a U.S. based multinational company. TGC has subsidiaries in several countries including Germany and the Czech Republic. The company is on a calendar year and all of its subsidiaries are on a calendar year. The auditors for the company are a Big Four firm and TGC received an unqualified opinion for 2003 and all prior years. TGC has not had any serious accounting irregularities. The company does recognize, however, that it lacks sufficient expertise in dealing with currency translations.

## Issues To Consider

1. The auditors have advised TGC that, under Sarbanes-Oxley, the CFO and CEO will be required to certify the company's internal controls.
2. On May 1, 2004 ten additional countries moved into the European Union.
3. All EU incorporated companies listed on EU regulated markets are required to prepare their first full consolidated IFRS accounts for 2005.
4. On August 1, 2004, TGC made a purchase from Osterhausen GmbH, a supplier in Germany, valued at 3,000,000 euro. The shipment was received November 1, 2004 and payment was made December 1, 2004. Because the accounting department was concerned about demonstrating that the controls related to currency transactions were in place, they intentionally set aside the recording of the purchase, the payment, and any gain or loss on currency.
5. Traditionally TGC insisted that all purchases outside the U.S. be denominated in the U.S. dollar; therefore the company had no experience in using derivatives to hedge against losses on currency transactions. At the time the purchase was made, the company considered entering into a forward contract at the 90-day or the 120-day exchange rate between the dollar and the Euro. Because of a lack of experience, a decision was made to not enter the forward contract.
6. Bergstraff GmbH is a wholly owned subsidiary of TGC located in Hamburg Germany. Bergstraff is a manufacturer of timing devices for premium automobiles. The majority of sales are made to Daimler-Chrysler in Germany. A smaller number of sales are made to BMW. Materials are purchased from suppliers in India and Mexico. All debt financing is done with German banks. Equity financing is provided by TGC through an inter-company account.
7. InstanTel is a wholly owned subsidiary of TGC with multiple locations in the Czech Republic. InstanTel makes a wide variety of apparel for women. The clothes are basically high quality knockoffs of brands that are popular with U.S. women, i.e. DKNY, Liz Claiborne etc. Most of the labor is performed in the Czech Republic. Material is purchased from low cost suppliers, some of which are in the Czech Republic and others are in India, Pakistan, and Turkey. The apparel is sold to high income women in the Czech Republic. The factories are financed through loans from the Czech government. Working capital is financed through revolving lines of credit from Czech banks.

### **The Assignment**

You are a key member of the TGC financial staff. The CFO was a partner in a major audit firm eight years ago. In addition, he has substantial experience in corporate finance. His experience in the field of multinational accounting is limited and he is concerned about providing the Sarbanes-Oxley certification of the internal controls related to the multinational aspects of accounting. For this reason, he has assigned you the task of checking into some specific issues in this area.

1. Prepare an analysis of the factors in the multinational accounting area that you would review with the CFO to determine if the company can provide the Sarbanes-Oxley certification.
2. TGC has subsidiary companies in many European countries. Prepare an analysis of countries in which subsidiaries will be required to prepare their first full consolidated

IFRS accounts for 2005. Prepare a similar analysis of countries joining the EU in May 2004 and give an estimate of when the subsidiaries in those countries will be required to prepare consolidated IFRS accounts.

3. Calculate the gains/losses on currency translation on the Osterhausen transaction at the third quarter (9-30-04) and at year end (12-31-04). Use the exchange rates in Exhibit 5.
4. How would the gains/losses calculated in item 3 have been impacted if TGC had entered a forward contract at the time of the Osterhausen purchase. Use the exchange rates in Exhibit 5.
5. Determine the functional currency and the foreign currency translation method for Bergstraff GmbH. Explain the conclusions you have reached.
6. Based on the determinations made in item 5, prepare a financial statement translation for Bergstraff for the year ended December 31, 2004. Explain the reasons for any gains/losses on currency translation.
7. Determine the functional currency and the foreign currency translation method for InstanTEL. Explain the conclusions you have reached.
8. Based on the determinations made in item 7, prepare a financial statement translation for InstanTEL for the year ended December 31, 2004. Explain the reasons for any gains/losses on currency translation.
9. Bergstraff and InstanTEL have traditionally prepared financial statements using U.S. GAAP. In 2005, it is likely that Bergstraff will be required to prepare full consolidated accounts under IFRS. Prepare an outline of the Bergstraff accounts that are likely to have a significant change as a result of transitioning from U.S. GAAP to IFRS.

Exhibit 1

**Bergstraff GmbH**  
**Income Statement**  
**For the Year ended December 31, 2004**

(All numbers in millions of Euros)

Sales	26,539
Cost of sales	<u>13,487</u>
Gross profit	13,052
Research and development	3,796
Selling, general and administrative	<u>4,464</u>
Operating income	4,792
Interest income	102
Interest expense	<u>472</u>
Income before tax	4422
Tax	<u>2104</u>
Net income	2318

Exhibit 2

**Bergstraff GmbH**

**Balance Sheet**

**December 31, 2004**

(All numbers in millions of Euros)

**Assets**

Current assets	
Cash and cash equivalents	7,404
Short term investments	3,382
Trading assets	1,801
Accounts receivable (net of allowance for doubtful accounts)	2,574
Inventories	2,276
Deferred tax assets	1,136
Other current assets	<u>352</u>
Total current assets	18,925
Plant, property and equipment, net	4,325
Other non-current asset	<u>1,200</u>
Total assets	24,450

**Liabilities and stockholders equity**

Current liabilities	
Short term debt	436
Accounts payable	1,543
Accrued compensation and benefits	1,287
Accrued advertising	622
Deferred income on shipments to middlemen	475
Other accrued liabilities	1,075
Income taxes payable	<u>1,157</u>
Total current liabilities	6,595
Long term debt	2,590
Stockholders equity	
Common stock	150
Inter-company account	4,789
Retained earnings	<u>10,326</u>
Total liabilities and stockholders equity	24,450

Exhibit 3

**Instantel**  
**Income Statement**  
**For the Year ended December 31, 2004**

(All numbers in millions of Korunas)

Sales	520,650
Cost of sales	<u>253,728</u>
Gross profit	266,922
Marketing and advertising	42,720
General and administrative	<u>35,622</u>
Operating income	188,580
Interest income	6,221
Interest expense	<u>102,520</u>
Income before tax	92,281
Tax	<u>27,684</u>
Net income	64,597

Exhibit 4

**InstanTEL**  
**Balance Sheet**  
**December 31, 2004**

(All numbers in millions of Korunas)

**Assets**

Current assets	
Cash and cash equivalents	110,221
Short term investments	55,301
Trading assets	1,522
Accounts receivable (net of allowance for doubtful accounts)	53,361
Inventories	49,633
Deferred tax assets	592
Other current assets	<u>662</u>
Total current assets	271,292
Plant, property and equipment, net	45,670
Other non-current asset	<u>3,102</u>
Total assets	320,064

Liabilities and stockholders equity

Current liabilities	
Short term debt	85,221
Accounts payable	25,633
Accrued compensation and benefits	1,051
Accrued advertising	312
Deferred income on shipments to middlemen	330
Other accrued liabilities	407
Income taxes payable	<u>561</u>
Total current liabilities	113,115
Long term debt	85,621
Stockholders equity	
Common stock	462
Inter-company account	20,010
Retained earnings	<u>100,856</u>
Total liabilities and stockholders equity	320,064

Exhibit 5

**Exchange Rates**

\$ U.S. per Euro

Spot rate quoted January 1, 2004	1.14
Spot rate quoted August 1, 2004	1.23
Spot rate quoted September 30, 2004	1.24
Spot rate quoted November 1, 2004	1.27
Spot rate quoted December 1, 2004	1.25
Spot rate quoted December 31, 2004	1.28
Forward rate quoted August 1, for delivery on November 1, 2004	1.26
Forward rate quoted August 1, for delivery on December 1, 2004	1.27
Average rate for the 12 months ended December 31, 2004	1.19

\$ U.S. per Koruna

Spot rate quoted January 1, 2004	.032
Spot rate quoted December 31, 2004	.041
Average rate for the 12 months ended December 31, 2004	.037