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KIRIRI WOMENS' UNIVERSITY OF SCIENCE AND TECHNOLOGY
UNIVERSITY EXAMINATIONS, 2024/2025 ACADEMIC YEAR
SECOND YEAR, FIRST SEMESTER EXAMINATION
FOR MASTER IN BUSINESS ADMINISTRATION (ACCOUNTING OPTION)

KAC 3207: INTERNATIONAL ACCOUNTING

DATE: 2ND DECEMBER, 2024
TIME: 11:00 AM – 2:00 PM

INSTRUCTIONS TO CANDIDATES
ANSWER QUESTION ONE (COMPULSORY) AND ANY OTHER THREE QUESTIONS

QUESTION ONE: COMPULSORY (40 MARKS)

Case Study: Royal Beverages Ltd. International Operations

Royal Beverages Ltd., a multinational beverage manufacturer headquartered in Nairobi, Kenya, has a vast network of subsidiaries operating across Africa, Europe, and Asia. The company's product line includes a variety of bottled drinks, including mineral water, sodas, and juices. Royal Beverages Ltd. oversees strategic decisions and manages intellectual property, including beverage formulas and processing technologies.

To streamline its operations, the company has a centralized procurement function in Kenya, responsible for sourcing raw materials, such as sugar and fruit extracts. These materials are then transferred to its manufacturing plants located in South Africa, Germany, and India, where the beverages are produced and distributed across respective regions.

Recently, Royal Beverages Ltd. has been facing increasing scrutiny from tax authorities over its transfer pricing policies and foreign exchange management practices. Additionally, the company is grappling with fluctuating exchange rates and cross-border transactions, which have raised concerns about financial reporting and tax compliance.

Intra-Group Transactions and Transfer Pricing

Royal Beverages Ltd. transfers sugar from its procurement hub in Kenya to its manufacturing subsidiary in South Africa. The cost of the sugar is KES 20 million, but the market price for similar sugar in South Africa is 10% higher. The South African tax authorities have raised concerns about the fairness of the transfer prices used, and are calling for a review of the pricing methodology.

Moreover, the German subsidiary, which licenses Royal Beverages' beverage formula, pays a 6% royalty on annual sales to the Kenyan parent company. However, local tax authorities in Germany have argued that the royalty rate should be higher, citing market conditions in the region.

Foreign Currency Translation and Consolidated Reporting

Royal Beverages Ltd. faces challenges in consolidating the financial statements of its foreign subsidiaries, especially in light of recent exchange rate fluctuations. For the year ending 31 December 2023, the South African subsidiary reported a profit of ZAR 25 million, while the German subsidiary reported €2 million in profits. The exchange rates at year-end were:

- 1 ZAR = KES 8
- 1 EUR = KES 155

The average exchange rates for the year were:

- 1 ZAR = KES 7.8
- 1 EUR = KES 150

Foreign Exchange Risks and Mitigation

The procurement hub in Kenya invoices the German subsidiary in Kenyan Shillings for raw materials sourced from Kenya. However, the German subsidiary conducts its operations in Euros. The fluctuating KES-EUR exchange rate has resulted in foreign exchange losses for Royal Beverages Ltd. The finance team is tasked with finding ways to mitigate these risks while maintaining smooth operations across borders.

Required:

a) Given that Royal Beverages is an international company, consider its transfer pricing based on the following:
   i. Using the cost-plus method and assuming a cost-plus margin of 10%, calculate the transfer price for the sugar sold from Kenya to South Africa. Show your calculations. **(6 Marks)**

ii. Recommend a suitable transfer pricing method for setting the royalty rate charged to the German subsidiary. **(4 Marks)**

b) Based on the nature of its operations, one major aspect of the company is foreign currency translation (FCT). Consider that in answering the following questions:

i. Explain the provisions of IAS 21 regarding foreign currency translation, particularly for subsidiaries operating in countries with different functional currencies. **(3 Marks)**

ii. Translate the profits of both the South African and German subsidiaries into Kenyan Shillings using the appropriate exchange rates (show your calculations). **(7 Marks)**

c) Royal Beverage is concerned about its Foreign Exchange Risk Management, you are tasked to:

i. Identify two types of foreign exchange risks that Royal Beverages Ltd. is exposed to in its transactions with its German subsidiary. **(4 Marks)**

ii. Recommend two strategies Royal Beverages Ltd. could use to mitigate these foreign exchange risks. Provide an example of how one strategy would work in this context. **(6 Marks)**

d) The company recently had transfer pricing disputes with revenue authorities for one of its subsidiaries in Europe.

i. Discuss the challenges multinational companies face when tax authorities in different countries dispute transfer pricing policies. **(4 Marks)**

ii. Propose possible remedies that Royal Beverages Ltd. could pursue to resolve potential disputes over the royalty rate charged to its German subsidiary. **(6 Marks)**

QUESTION TWO: (20 MARKS)

You are the new Chief Finance Officer at Kijani Ltd. an international company with operations in Kenya and the United States. These two markets use different accounting standards and the Management has tasked you to;

a) Explain the significance of harmonizing International Financial Reporting Standards (IFRS) and Generally Accepted Accounting Principles (GAAP) and related challenges in achieving global convergence of these standards. **(8 Marks)**

b) Explain the use of hedging instruments, such as forward contracts and options, in mitigating foreign exchange risk. Provide an example of how a forward contract would work in practice for Kijani Ltd. **(6 Marks)**

c) Discuss the differences in accounting for leases under IFRS 16 and GAAP (ASC 842) focusing on how they impact the financial statements of a multinational entity. **(6 Marks)**

QUESTION THREE: (20 MARKS)

The Institute of Certified Public Accountants of Kenya (ICPAK) has invited you to an international conference as a key speaker. You have been requested to prepare a presentation touching on the areas suggested below.

a) Discuss the importance of Double Taxation Agreements (DTAs) in international taxation and how they influence the tax liabilities of multinational corporations. **(7 Marks)**

b) Explain how transfer pricing policies affect financial reporting by using a practical example to show how the pricing of intercompany transactions can influence the income reported by multinational entities. **(7 Marks)**

c) Describe the role of tax havens in multinational tax planning and the ethical implications of using these havens to minimize global tax liabilities. **(6 Marks)**

QUESTION FOUR: (20 MARKS)

a) Discuss the challenges that hyperinflation poses to multinational entities when consolidating financial statements. Highlight how such challenges could impact investor decisions. **(7 Marks)**

b) Analyze the role of purchasing power parity (PPP) theory in understanding the effects of inflation on exchange rates. Provide an example of how PPP impacts a multinational's foreign currency transactions. **(7 Marks)**

c) Discuss how inflation impacts the presentation of financial statements and the necessary adjustments that may be necessary to maintain the accuracy of financial reporting during periods of high inflation. **(6 Marks)**

QUESTION FIVE: (20 MARKS)

a) Analyze the accounting challenges posed by blockchain technology and cryptocurrencies and how these digital assets are accounted for under current IFRS standards. **(7 Marks)**

b) Discuss the importance of sustainability reporting in global business focusing on the key components of Environmental, Social, and Governance (ESG) disclosures under integrated reporting frameworks. **(8 Marks)**

c) Highlight recent developments in IFRS standards exploring how these changes address the evolving needs of global businesses. **(5 Marks)**