

KEY ACCOUNTING PROBLEMS RELATED TO THE STRATEGIES OF INTERNATIONAL TRANSFER PRICING IN MODERN GLOBALLY OPERATING COMPANIES

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Abstract: This paper treats the role and significance of international transfer pricing in the activities of modern globally operating companies in the contemporary conditions of constantly increasing globalization of the world economic area. The main goals and tasks pursued by the mechanism of international transfer pricing in the hyper competitive, highly risky and dynamically changing global business environment are explained. The key accounting problems related to the processes of planning, analysis and control of specific strategies of international transfer pricing in the globally oriented companies are discussed.

The rapid development of globalization processes in contemporary conditions determines the growth of the significance and application of international transfer pricing in the activities of modern globally operating companies. Increasing the degree of their economic integration and the amount of their intra-corporate exchange, as well as the increasing complexity of their international transactions, make international transfer pricing one of the most important and topical problem that is faced by these companies. The main goal pursued by the mechanism of international transfer pricing is to optimize activities and maximize overall profits for the company as a whole on a global basis.

The accounting problems that may arise in connection with international transfer pricing in modern globally operating companies are in two main aspects:

- problems in terms of information provision of the internal management processes that occur in the different subsidiaries and within the company as a whole;
- problems in providing the necessary accounting information for the purpose of compiling the financial statements and satisfying the information needs of the interested external users.

The accounting information system of globally operating companies should be able to meet the information needs of their distinctive uniform system of making decisions aimed at coordinating goals on a global basis, successfully implementing the global strategy and optimizing resources and results globally. The accounting must provide adequate information needed to make sound management decisions concerning the policy of international transfer pricing that is implemented, to control the implementation of these decisions and subsequently to assess and analyze the results.

A key problem for globally operating companies is implementing such a policy of international transfer pricing that ensures optimal results for the company as a whole and at the same time successful practical implementation of the requirement for consistency of the goals of all units operating within the overall organizational structure. Considerable difficulties arise in the objective assessment of costs and benefits of the application of transfer prices in the implementation of numerous and diverse international operations between the different constituent structural units of the company and the making of sound management decisions based on this.

Keywords: accounting, international transfer pricing, globalization.

1. INTRODUCTION

The rapid development of globalization processes in the contemporary conditions determines the growth of the significance and application of international transfer pricing in the activities of modern globally operating companies. These companies view the whole world as a single source for supplying resources and as a single global space to develop their various production, trade and other activities. It is typical for globally oriented companies that the central management, through global integration and coordination of the activities, strive after improving the general profitability of the company as a whole, after maximizing global profit and achieving global optimization. By pursuing such goals these companies often use specific mechanisms for manipulating the costs, revenues and profit of their foreign subsidiaries in view of decreasing the amount of the taxes paid as a whole on a global scale, decreasing the import duties, etc. Increasing the degree of their economic integration and the amount of their intra-corporate exchange, as well as the increasing complexity of their international transactions, make international transfer pricing one of the most important and topical problem that is faced by these companies. This pricing raises a number of challenges both for companies that have foreign subsidiaries in different countries and carry out a variety of international transfer operations on a global scale and for the tax administrations of the countries in which they operate. The results of numerous globally conducted studies clearly confirm the particular significance that today is given to the problems of international transfer pricing

and show that the modern globally operating companies consider transfer pricing as the biggest international tax problem for them in the present and in the near future.

2. MAIN GOALS AND TASKS OF THE STRATEGIES OF INTERNATIONAL TRANSFER PRICING IN MODERN GLOBALLY OPERATING COMPANIES. EXTERNAL AND INTERNAL LIMITING FACTORS ON THE APPLICATION OF INTERNATIONAL TRANSFER PRICING IN THE CONTEMPORARY CONDITIONS

International transfer pricing is inherently the process of determining the prices, at which intra-corporate sales of various assets or services are carried out between related parties in a company. These specific transfer prices differ from the prices operating on the free market and used in transactions between independent parties. They can be determined based on the market conditions, but may not be consistent with them.

The main goals pursued by the mechanism of international transfer pricing are to optimize activities and to maximize overall profits for the company as a whole on a global basis. Achieving these main goals in the conditions of hyper competitive, highly risky and dynamically changing global business environment requires fulfilling the following basic tasks:

- minimize the amount of taxes paid on profits worldwide;
- minimize the amount of customs paid globally;
- avoid restrictions imposed by the countries, in which the different foreign subsidiaries of the company operate, to regulate and control their activities - for example restrictions on repatriation of profits, foreign exchange control, control over the amount of intra-corporate exchange, etc.
- overcome the adverse effects of changes in exchange rates.

In addition to these basic tasks that globally oriented companies seek to achieve through international transfer pricing, they may seek to manipulate the profits and profitability of the different foreign subsidiaries based on reasons such as:

- winning the confidence of credit institutions in the relevant foreign countries and providing lending by them;
- achieving marketing objectives related to the life cycle of products;
- entering new markets;
- eliminating rivals from certain markets, etc.

External and internal limiting factors act on the application of international transfer pricing in the contemporary conditions. The external limiting factors to the company are the regulatory measures introduced by the different countries, aiming at limiting and countering the attempts at manipulation by companies to reduce the taxes paid on profits, customs duties and others through the mechanism of international transfer pricing. The current national legislation of the different countries around the world usually contains special provisions relating to the settlement of transfer pricing issues. Transfer prices are one of the most problematic aspects of the relationship between companies that carry out global business and regulatory authorities of the countries in which they operate. Along with the increasing significance and application of transfer prices in international operations due to the rapid development of the globalization processes, increasing attention is paid to the problem of improving control measures in this area.

The internal limiting factors on the application of international transfer pricing are the intra-corporate management problems that the use of transfer prices inevitably brings and the need to ensure that the benefits of the transfer pricing strategies exceed the disadvantages caused by them to the company.

3. KEY ACCOUNTING PROBLEMS RELATED TO THE PROCESSES OF PLANNING, ANALYSIS AND CONTROL OF SPECIFIC STRATEGIES OF INTERNATIONAL TRANSFER PRICING IN GLOBALLY OPERATING COMPANIES

The accounting problems that may arise in connection with international transfer pricing in modern globally operating companies are in two main aspects:

- problems in terms of information provision of the internal management processes that occur in the different subsidiaries and within the company as a whole (processes of planning, analysis, control and coordination of the activities);
- problems in providing the necessary accounting information for the purpose of compiling the financial statements and satisfying the information needs of the interested external users.

The accounting information system of globally operating companies should be able to meet the information needs of their distinctive uniform system of making decisions aimed at:

- coordinating goals on a global basis;
- successfully implementing the global strategy;
- optimizing resources and results globally.

International transfer pricing has a significant impact both on the overall activities of the company and the activities of each of its foreign subsidiaries. It largely affects the internal processes of planning, control and analysis of the activity that are going on within the company. The strategy of international transfer pricing should be taken into account already in the strategic planning process and embedded in the development of plans relating to the activities of the constituent subsidiaries and the overall business of the company. This strategy should be tailored to the individual characteristics of each subsidiary, the peculiarities of the environment in the country in which it operates, its specific operational links with the parent-company and its specific role in the overall activity of the company. It cannot be the same to the different subsidiaries and also has to be updated in line with the dynamic changes occurring in the conditions under which they operate.

The use of international transfer prices in globally oriented companies brings a number of peculiarities and difficulties in the processes of control and analysis of the performed activities. Some of the major problems in this respect are related to the creation of an effective system of measures to assess the activities of each subsidiary and of its manager, while taking into account and eliminating from assessment the effect that transfer pricing has on the results achieved. All this clearly shows that it is crucial the accounting information system of globally operating companies to create and provide adequate information needed to make sound management decisions concerning the policy of international transfer pricing that is implemented, to control the implementation of these decisions and subsequently to assess and analyze the results.

Among the most significant parameters of the international environment, which significantly affect decision-making regarding the selection of specific strategies of international transfer pricing in the business of globally oriented companies, are:

- the restrictions on the repatriation of profits of foreign subsidiaries, imposed by the host-countries, in which they operate;
- the foreign exchange control exercised by the countries, in which the foreign subsidiaries function;
- the taxation of profits in the countries, in which the company operates;
- the customs duties and policy of import restrictions applied by the different countries, in which the company operates;
- the market conditions and competition in the different countries;
- the economic, legal and political stability in the different countries;
- the differences in the levels of inflation;
- the changes in exchange rates of the currencies.

The arrangement of these parameters according to their degree of significance may be different depending on the type of countries, in which the company operates through its foreign subsidiaries. The priorities are different in the cases where the subsidiaries operate in highly developed, respectively poorly developed countries in economic terms. There should be different strategies of international transfer pricing, corresponding to the specific conditions of the environment, in which the foreign subsidiaries function.

Differences in the practice of globally operating companies in terms of the strategies of transfer pricing are determined by important prerequisites such as:

- the size of the company;
- the degree of globalization of activities;
- the specific characteristics of the activities carried out by the company in various economic spheres;
- the management organizational structure of the company;
- the degree of centralization of management of the company;
- the differences in the applied management approaches;
- the differences in the factors influencing transfer pricing;
- the variety of parameters of the different environments in the different countries, in which the foreign subsidiaries function;
- the requirements of the current legislation regarding international transfer pricing in the different countries, in which the company operates.

A key problem for globally operating companies is implementing such a policy of international transfer pricing that ensures optimal results for the company as a whole and at the same time successful practical implementation of the requirement for consistency of the goals of all units operating within the overall organizational structure. It is extremely difficult, starting from a global perspective, to find the right approaches and methods in the development of pricing policy by the central management so that globally to achieve the various tasks simultaneously pursued through the mechanism of international transfer pricing. Considerable difficulties arise in the objective assessment of costs and benefits of the application of transfer prices in the implementation of numerous and diverse international operations between the different constituent structural units of the company and the making of sound management decisions based on this. Any management decision related to transfer prices affects both the different subsidiaries that are involved in the international transactions

performed and the company as a whole. Foreign subsidiaries operate in different environments and conditions in such environments are constantly changing, which largely hinders the processes of decision-making. Decisions should be consistent with the impact of a significant number of specific parameters of the environment and require excellent knowledge of the tax policy conducted by each of the countries in which the company operates. The complex task of optimizing the tax liabilities of the company as a whole and of each of its subsidiaries, as well as the enormous impact of taxation on profitability and cash flows, determine the need to ensure an effective system of tax planning. Tax issues are important in deciding “(1) where to locate a foreign operation, (2) what legal form the operation should take, and (3) how the operation will be financed”. [2, p.541] Differences in taxation around the world bring a number of challenges to globally operating companies and have a significant influence on their decisions regarding the selection of: [1, p.586]

- a place for capital investment;
- forms of carrying out international operations (through import, export, licensing agreements, foreign investments, etc.);
- legal form when opening new subsidiaries;
- methods of financing subsidiaries (from internal or external sources, through debt, equity contributions, etc.);
- methods of determining transfer prices.

A fundamental problem in the management of globally operating companies, associated with the application of international transfer prices, is that transfer prices give rise to a conflict between the interests of the company as a whole and the interests of the different subsidiaries that are involved in the transfer operations. At the same time, it is essential for a globally operating company to coordinate the goals, which means to pursue a non-conflict reconciliation of the interests between all structural units and the company as a whole. The fact that the decisions of the central management are aimed at optimizing the results on a global basis, including through the use of a flexible system of transfer prices, requires the managers of the different subsidiaries to work towards achieving the common goals, even when this does not conform and is even contrary to their personal interests and also at the expense of the specific results reported by the subsidiary. Manipulating transfer prices, which is based on specific objectives and priorities of the company and not on the actual market conditions and changes in them, renders meaningless the use of profits and other profit-based financial indicators, reported in the financial statements of the subsidiaries, as adequate indicators for assessing the activity and quality of their management. If the financial results and financial position of foreign subsidiaries are strongly influenced by the applied transfer prices, the information in the financial statements intended for the tax authorities and other external users will not be an appropriate basis for making decisions by the central management in carrying out the internal processes of control and analysis of the activities. Serious problems arise, when this information is used to assess the activities of the managers of the subsidiaries, without taking into account the fact that transfer prices have been used to reduce the profits in order to reduce the tax liabilities. Misjudgements have an adverse impact on their motivation and behaviour and can result into decisions that are not in favour of the company as a whole. Underestimating these problems in the long term can lead to a destruction of the achieved short-term effect of reducing taxation and the inability to achieve the benefits pursued through international transfer pricing. This, in turn, requires developing a system of appropriate measures to reliably evaluate the activities of the subsidiaries, which allow taking into account the effect of transfer prices, goals and tasks pursued through their use. These measures should be consistent with the specific plan objectives set to be performed by the managers, the scope of their responsibilities and the degree of their control over the results of operations performed. For this purpose the central management of the company should be provided with adequate accounting information in sufficient detail that enables to track and analyze the impact of the applied strategies of international transfer pricing and to make the right decisions regarding the activities of the different foreign subsidiaries.

4. CONCLUSION

The specific strategies of international transfer pricing entail specific requirements for the organization of the processes related to the creation and communication of accounting information for adoption of management decisions at the different management levels of the company. It is particularly important to invest special efforts to optimize information provision so as to ensure, on the one hand, carrying out a thorough evaluation and analysis of the objectives of the strategies of international transfer pricing, achieved as a result of the overall activities of the company worldwide, and, on the other hand, of the effectiveness of the activities of the various foreign subsidiaries and their managers. The efficient use of accounting information in the internal processes of planning, control and analysis of strategies of international transfer pricing is a key premise for improving the general profitability of the company as a whole on a global basis and for achieving global optimization. It is of exceptional significance to achieve efficient management of the complex information processes running in the globally operating companies and the information provided by the accounting to be maximally complied with the specific information needs at the different management levels.

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