Case 11-4 college essay

SUBJECT: Determining the Functional Currency of Sparkle Company Sparkle Company is a Nigerian diamond mining company. Sparkle is a joint venture, 50 percent owned by Shine and 50 percent owned by Brighten. Both Shine and Brighten are U. S. -based companies with their functional currency being the American dollar. Sparkle Companies functional currency is that of Nigeria, being the Naira. During 2009, Sparkle had several transactions with its joint venture owners and outside parties.

The details of Sparkle's transactions are three loans, three expenditures, and one revenue stream. The loans the company took out were $1 million from Brighten, $1 million from Shine, and 300 million Naira from a local Nigerian bank. The expenditures for 2009 included 850 million Naira on local labor, 75 million Naira on operating expenses, and $15 million on machinery. The revenue streams for the current period for Sparkle are $35 million in sales within the United States, which equals 80 percent of total sales.

According to the joint venture agreement, all sales proceeds are retained by Sparkle as long as control is equally divided between Shine and Brighten. Direct sales transactions with Shine and Brighten are considered to be relatively small. During 2009 the exchange rate was 1US$ to 140NGN. Intragroup transactions were denominated in the functional currency of the joint venture. Sparkle has a strong Nigerian management team and an experienced ex-Brighten managing director. U. S. laws govern the diamond trade worldwide and all sales are made in US$.

In 2010 Shine sold its share in the joint venture to Brighten. Though the loan was included in the sale, all of the other mentioned factors remained consistent in 2010. Brighten is considering the accounting implications of switching from U. S. GAAP to IFRSs at the end of fiscal year 2010. Comparative financial statements would include fiscal year 2009. In 2009, on the basis of its consideration of the factors in ASC 830-10-55-3 through 55-7 Brighten had concluded that the NGN is the functional currency of Sparkle.

This conclusion was appropriate because (1) all recurring Sparkle expenditures are denominated in NGN, (2) Sparkle carries significant local debt (NGN denominated), and (3) while sales are denominated in dollars, the cash flows are retained locally (i. e. , they are not readily available for remittance to Shine or Brighten). Brighten has not made a determination as to whether the functional currency should change in 2010 because of the acquisition of the other 50 percent ownership share. According to IAS 21, functional currency is the currency of the primary economic environment in which the entity operates.

The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. Taking this into consideration the functional currency for Sparkle during 2009 would be the US$ based on the given information for 2009 there are more cash transactions using the US$ than NGN. During 2010 under GAAP the functional currency for Sparkle would be the US$. According to FAS 52, A currency in a highly inflationary environment is not considered stable enough to serve as a functional currency and the more stable currency of the reporting parent is to be used instead.

During 2010 under IFRSs, using IAS 21, the functional currency for Sparkle would be the US$ for 2010. Although Shine sold its share of the joint venture to Brighten the loan would be transferred and the amount of American currency to NGN would remain the same. 10-3 Case: Restructure Costs Case 1) According to IAS 37, paragraph 72, “ A constructive obligation to restructure arises only when an entity: (a) has a detailed formal plan for the restructuring identifying at least: (i) the business or part of a business concerned; (ii) the principal locations affected; iii) the location, function, and approximate number of employees who will be compensated for terminating their services; (iv) the expenditures that will be undertaken; and (v) when the plan will be implemented; and (b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it. “ By making the press release and communicating the termination plan to its employees , Pharma Co raised a valid expectation to those affected by announcement of the plan.

Also, Pharma Co set the date when the plan will be implemented, the principle location affected, the part of the business concerned, the number of employees who will be terminated, and the expenditures that will be undertaken. According to IAS 37, paragraph 80, “ A restructuring provision shall include only the direct expenditures arising from the restructuring, which are those that are both: (a) necessarily entailed by the restructuring; and > (b) not associated with the ongoing activities of the entity. “ Thus, only direct costs must be accrued in the end of 2010: the lease termination fee $1. mln and the exit package for the terminated employees $3 mln. Cost of dismantling the old equipment should not be accrued as a restructuring cost because there is no legal liability to do so, and it was not the practice of Pharma Co to dismantle the old equipment when abandoning plant before. Therefore, this is not a cost necessary entailed by the restructuring. The costs of moving and retraining the employees are specifically excluded by paragraph 81. Thus, Pharma Co should show the restructuring provision of $4. 3 mln on its 2010 year end balance sheet.) According to the US GAAP ASC 420-10-05-2, “ Those costs include, but are not limited to, the following: 3) a. Involuntary employee termination benefits pursuant to a one-time benefit arrangement that, in substance, is not an ongoing benefit arrangement or an individual deferred compensation contract b. Costs to terminate a contract that is not a capital lease c. Other associated costs, including costs to consolidate or close facilities and relocate employees. Thus, amounts paid to personnel (salaries and benefits) to close a plant down, subsequent to termination of operations must be accrued as a restructuring charge.

The cost of retraining the employees is a restructuring cost, but it must be recorded as occurred, because these costs relate to future benefits. The lease termination fee must be recorded when the termination of lease is communicated to the lender. Pharm Co received oral lease termination agreement, and therefore this charge can be accrued as relocating. Moving costs are considered restructuring costs, but as they will benefit continuing activities, they must be expensed as occurred.