Name: Anukwu joy Anwulinka

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Department: Accounting

Level: 400

Course: Acc406 (International Accounting)

ASSIGNMENT

INTERNATIONAL TRANSFER PRICING

Transfer pricingrefers to the determination of the price at which transactions between related parties will be carried out. Transfers can be from a subsidiary to its parent (upstream), from the parent to a subsidiary (downstream), or from one subsidiary to another of the same parent. Transfers between related parties are also known as intercompany transactions***.*** Intercompany transactions represent a significant portion of international trade.

Factors affecting transfer pricing

1. The objective that headquarters management wishes to achieve through its transfer pricing practices. One possible objective relates to management control and performance evaluation. Another objective relates to the minimization of one or more types of costs.

2. The law that exists in most countries governing the manner in which intercompany transactions crossing their borders may be priced.

DECENTRALIZATION AND GOAL CONGRUENCE

Decentralizationhas many advantages, including the following:

i. Allowing local managers to respond quickly to a changing environment.

ii. Dividing large, complex problems into manageable pieces.

iii. Motivating local managers who otherwise will be frustrated if asked only to implement the

decisions of others.

TRANSFER PRICING METHODS

Cost-based transfer price: The transfer price is based on the cost to produce a good or service. Cost can be determined as variable production cost, variable plus fixed production cost, or full cost, based on either actual or budgeted amounts (standard costs). The transfer price often includes a profit margin for the seller (a “cost-plus” price).

Market-based transfer price***:*** The transfer price charged a related party is either based on the price that would be charged to an unrelated customer or determined by reference to sales of similar products or services by other companies to unrelated parties.

Negotiated price: The transfer price is the result of negotiation between buyer and seller and may

be unrelated to either cost or market value. A negotiated pricing system can be useful, as it allows subsidiary managers the freedom to bargain with one another, thereby preserving the autonomy of subsidiary managers.

OBJECTIVES OF INTERNATIONAL TRANSFER PRICING

Performance Evaluation

Cost Minimization

Conflicting Objectives

Improve Competitive Position of Foreign Operation