NIMFA JOSIAH

16/SMS02/039

ACC 406

Transfer pricing refers 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. Two factors heavily influence the manner in which international transfer prices are determined. The first factor is the objective that headquarters management wishes to achieve through its transfer pricing practices. The second factor affecting international transfer pricing is the law that exists in most countries governing the manner in which intercompany transactions crossing their borders may be priced.

**DECENTRALIZATION AND GOAL CONGRUENCE**

In a company organized by division, top managers delegate or decentralize authority and responsibility to division managers. Decentralization has many advantages, including the following:

1. Allowing local managers to respond quickly to a changing environment.
2. Dividing large, complex problems into manageable pieces.

Goal congruence is the accounting and control system designed to provide incentives for local managers to make decisions that are consistent with corporate goals.

**TRANSFER PRICING METHODS**

1. **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).
2. **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.
3. **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:** To fairly evaluate the performance of both parties to an intercompany transaction, the transfer should be made at a price acceptable to both parties.

**Cost Minimization:** The most well-known use of discretionary transfer pricing is to minimize worldwide income taxes by recording profits in lower-tax countries.

**Conflicting Objectives:** One way that companies deal with this conflict is through dual pricing. The official records for tax and financial reporting are based on the cost-minimizing transfer prices.