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**INTERNATIONAL TRANSFER PRICING**

Transfer pricing has to do with determining the price at which related parties (parent & subsidiary or same of each) can carry out transactions. These transactions are known as intercompany transactions. Both existing laws and management objectives affect transfer pricing.

**Decentralization and Goal Congruence**

Usually, top managers delegate or decentralize authority and responsibility to division managers. This has advantages such as:

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

The major disadvantage of this however, is that local managers who have been granted decision-making authority may make decisions that are in their self-interest but detrimental to the company as a whole. From this arises the need for goal congruence which is the need for local managers to make decisions that are consistent with corporate goals.

**Methods of Determining Transfer Pricing**

1. **Cost-based transfer price**: The transfer price is based on the cost to produce a good or service.
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.

**Objectives of Transfer Pricing**

The objectives of transfer pricing are:

1. Performance evaluation
2. Cost minimization

There is an inherent conflict between the performance evaluation and cost- minimization objectives of transfer pricing. To minimize costs, top managers must dictate a discretionary transfer price. By definition, this is not a price that has been negotiated by the two managers who are party to a transaction, nor is it necessarily based on external market prices or production costs. The benefits of decentralization can evaporate when headquarters managers assume the responsibility for determining transfer prices.

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. When it comes time to evaluate performance, however, the actual records are adjusted to reflect prices acceptable to both parties to the transaction factoring out the effect of discretionary transfer prices. Actual transfers are invoiced so as to minimize costs, but evaluation of performance is based on simulated prices.

Other Cost-Minimization Objectives include

1. Avoidance of Withholding Taxes
2. Minimization of Import Duties (Tariffs)
3. Circumvent Profit Repatriation Restrictions
4. Protect Cash Flows from Currency Devaluation