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A Comparison of Accounting Practices of the United States and Mexico

Kenya Watts

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NORTHERN ILLINOIS UNIVERSITY

A Comparison of Accounting

Practices of the United States and Mexico

A Thesis Submitted to the University Honors Program

In Partial Fulfillment of the

Requirements of the Baccalaureate Degree

With University Honors

Department of Accountancy

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ABSTRACT

With increased globalization the need for more harmonious accounting principles intensifies. Since ^{of} hope to spend some time working as an accountant in Mexico, ⁺ he purpose of this project was to acquaint myself with the structure of Mexico's accounting body. I set out to learn and understand the structure of the standard-setting body, the certification requirements, the GAAP hierarchy, the conceptual framework and the significant accounting differences. I approached my research using books, the Internet, and periodicals. I was able to locate an abundance of information on Mexico as a whole but accounting related information was more difficult to come by. I was able to come across enough resources to complete my project but more current information would have been more useful.

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INDEX OF ACRONYMS

AAA	American Accounting Association
AICPA	American Institute of Certified Public Accountants
AIMR	Association for Investment Management and Research
APB	Accounting Principles Board
APC	Accounting Principles Commission
EITF	Emerging Issues Task Force
FAF	Financial Accounting Foundation
FASAC	Financial Accounting Standards Advisory Council
FASB	Financial Accounting Standards Board
FEI	Financial Executive Institute
FIFO	First In First Out
GAAP	Generally Accepted Accounting Principles
GASB	Governmental Accounting Standards Board
IMA	Institute of Management Accountants
LIFO	Last in First Out
MIPA	Mexican Institute of Public Accountants
NEC	National Executive Committee
NSC	National Securities Commission
R & D	Research and Development
SEC	Securities Exchange Commission
SIA	Securities Industry Association

INTRODUCTION

Mexico borders the southern part of the United States and a great deal of the western United States used to be a part of the Mexican Republic. With such strong territorial ties, cross-border trading, benchmarking, globalization and other things ~~has~~^{have} been inevitable for the United States and Mexico. There are U.S. companies expanding into Mexico and there are Mexican companies moving into the United States. Along with ~~these~~^{this} expansion comes significant national barriers, such as language, economic performance, culture, ~~and~~ etc. In addition to these barriers, companies must struggle with the differences in accounting and reporting practices. Since U.S. Generally Accepted Accounting Principles are more developed and widely recognized than those of Mexico, the latter has been faced with the need to advance its accounting and reporting ideology. As a means of furthering the desire for more compatibility, the accounting standard-setting body of Mexico became one of the founding members of the International Accounting Standards Committee. As Mexico works toward harmonization with U.S. GAAP, measures should be taken to understand Mexico's accounting background and the significant accounting differences it must overcome.

THE STANDARD SETTING BODIES

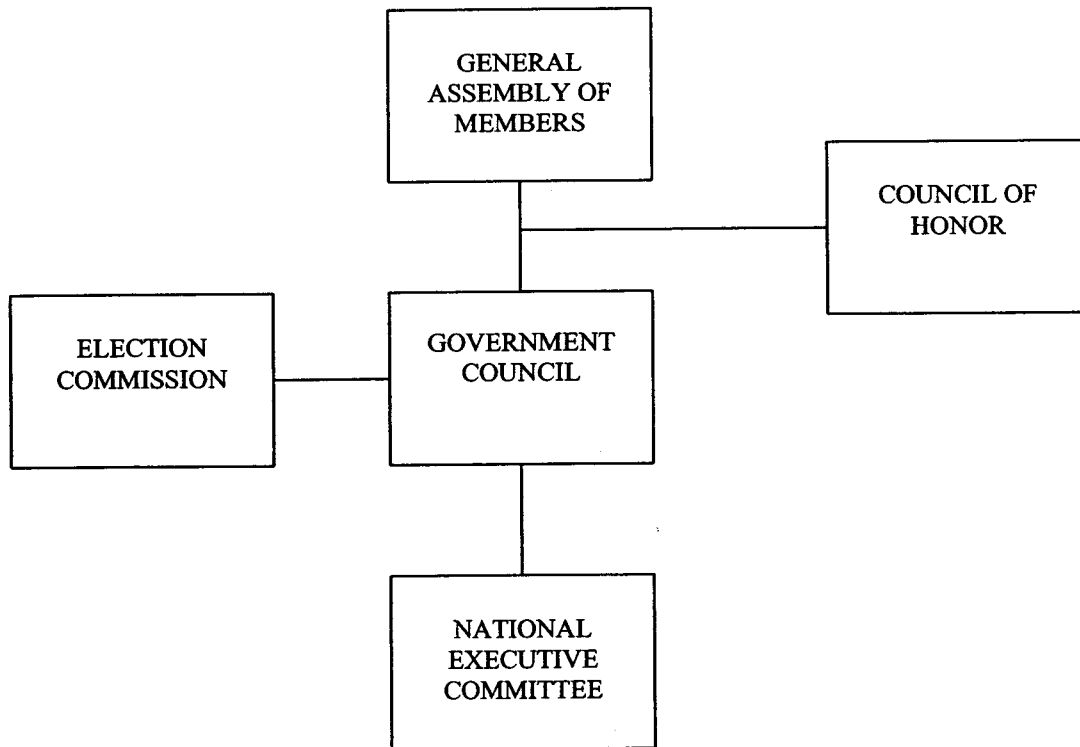
Mexican Institute of Public Accountants

In 1964, the Mexican Institute of Public Accountants would become the representative body of the accounting profession in Mexico. MIPA's recognition as professional institute would come later in 1977. The MIPA is a federation of approximately 60 federated associations (Federadas) and over 16,000 public accountants. Its primary objective is to expand the public accounting profession while at the same time making it more dignified and prestigious. The MIPA's primary duty is to consider the public interest in the establishment and communication

of accounting principles and to encourage nation-wide acceptance and observance of these principles. The funding for the MIPA comes from voluntary contributions of capital and manpower. No member receives pay for his or her participation in MIPA activities. The entire institution is based on voluntary contribution^s. A majority of these contributions come from the companies for which the members work.

Three bodies govern the MIPA. The General Assembly of Members and the Government Council execute the sponsoring and overseeing functions while the National Executive Committee manages the day-to-day activities of the MIPA.

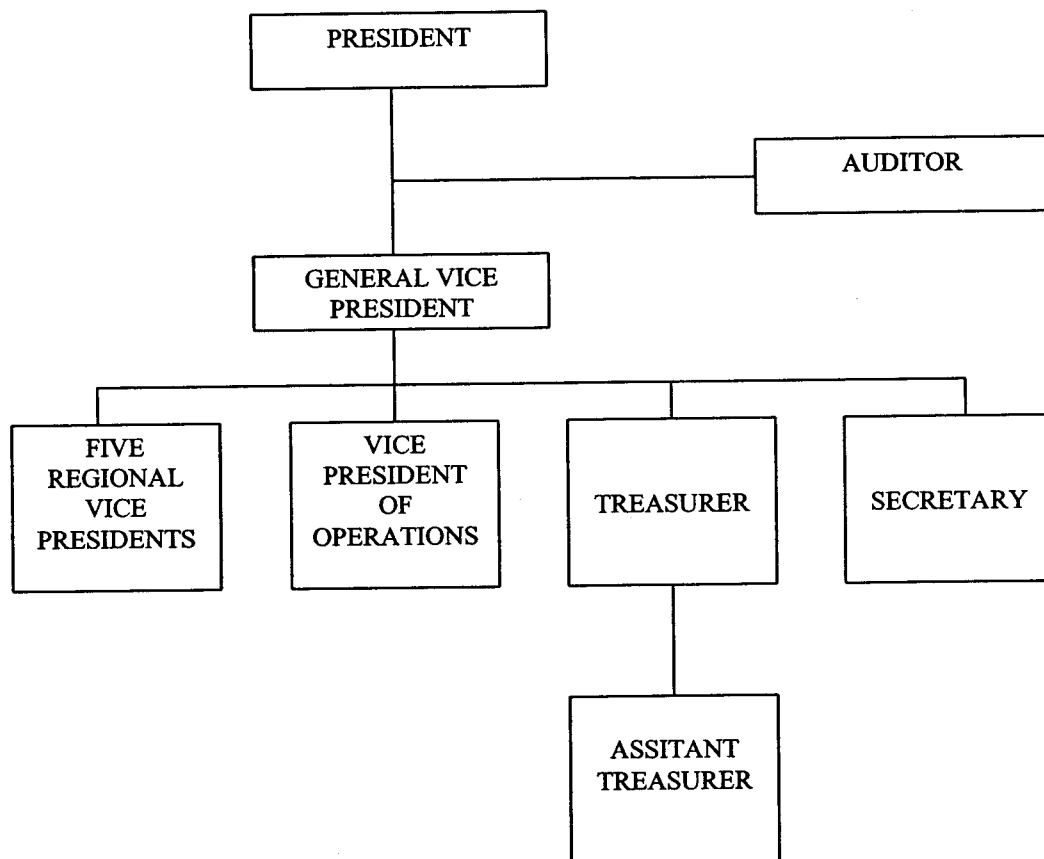
MIPA governing bodies



The Council of Honor and the Election Commission are composed of MIPA ex-presidents and members that have been involved with the Institute for ten years or more. Their purpose is to provide guidance and support to the General Assembly of Members and the Government

Council. The General Assembly of Members is composed of members of the Federadas and the Government Council consists of a president from each Federada and the 17 elected members of the National Executive Committee.

The NEC structure



Accounting Principles Commission

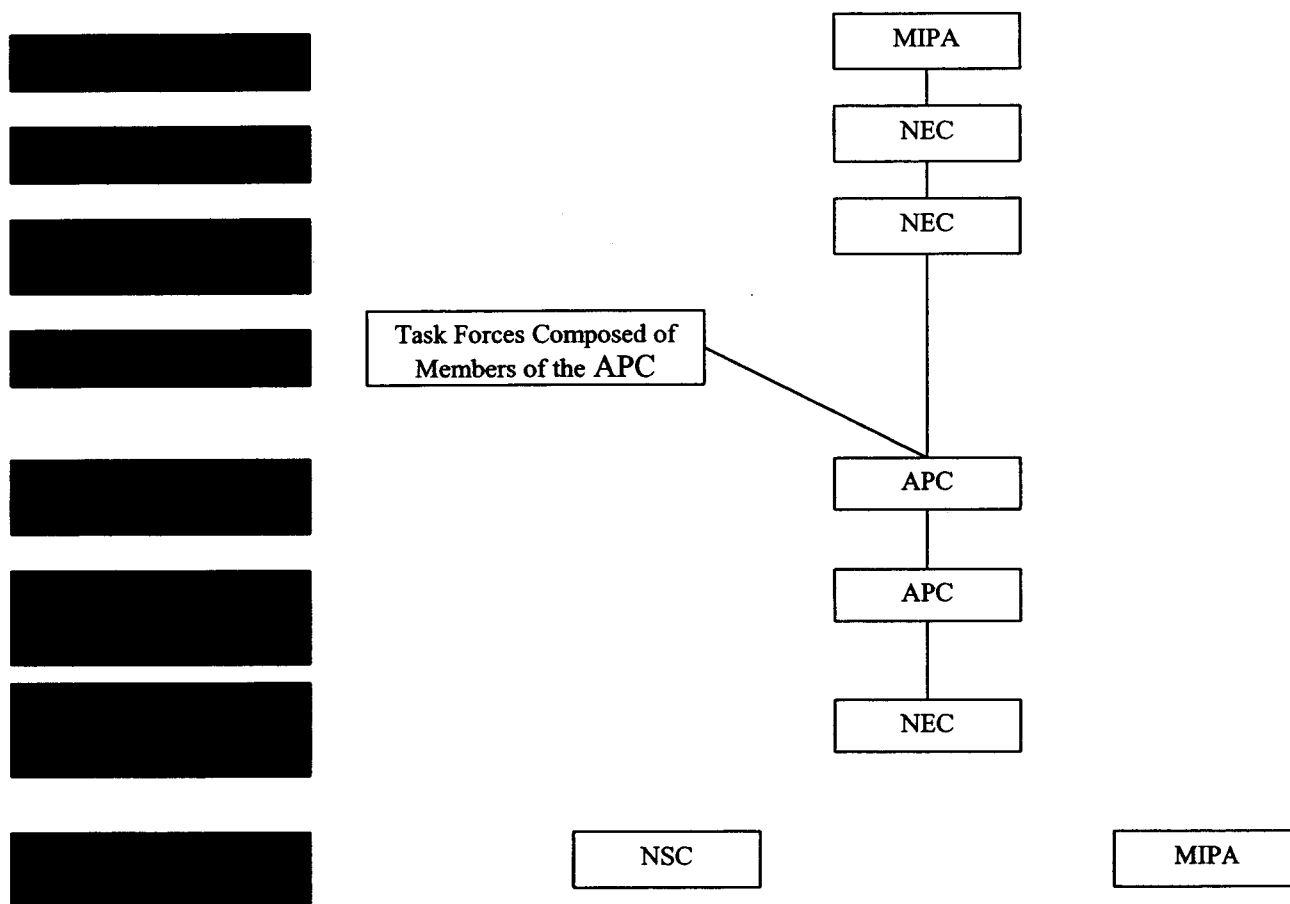
The MIPA has overall authority on the accounting profession as a whole but it established the Accounting Principles Commission to act as a conduit for the proposing of accounting principles. The APC is composed of public accountants and National Securities Commission representatives. This APC is responsible for proposing pronouncements that reform, add to, or update current GAAP. Their suggestions provide external users with the

necessary framework for the proper preparation and presentation of financial accounting information.

National Securities Commission

Where as the APC makes proposal for changes to GAAP, the National Securities Commission actually has the responsibility for issuing the pronouncements. Standards are issued after approval by 2/3 vote of the NEC. The NEC is very comparable to the SEC. It issues specific accounting rules for companies listed on the Mexican Stock Exchange and it requires that all listed companies comply with Mexican GAAP.

Standard-setting structure of the MIPA



The MIPA standard setting process is slightly different in that it must be approved by the APC and then by the NEC.

1. Project proposal-can be generated from different bodies within the MIPA
2. Issue papers (optional)-used for complex projects, method of obtaining the views of interested parties
3. Statement of principles-developed by the task force and then must be approved by 2/3 of APC before the next stage can begin
4. Exposure draft-open to public comment for two months, then once the final proposal is approved by APC it goes to the NEC
5. Final standard-review of exposure draft comments and then developed for final consideration

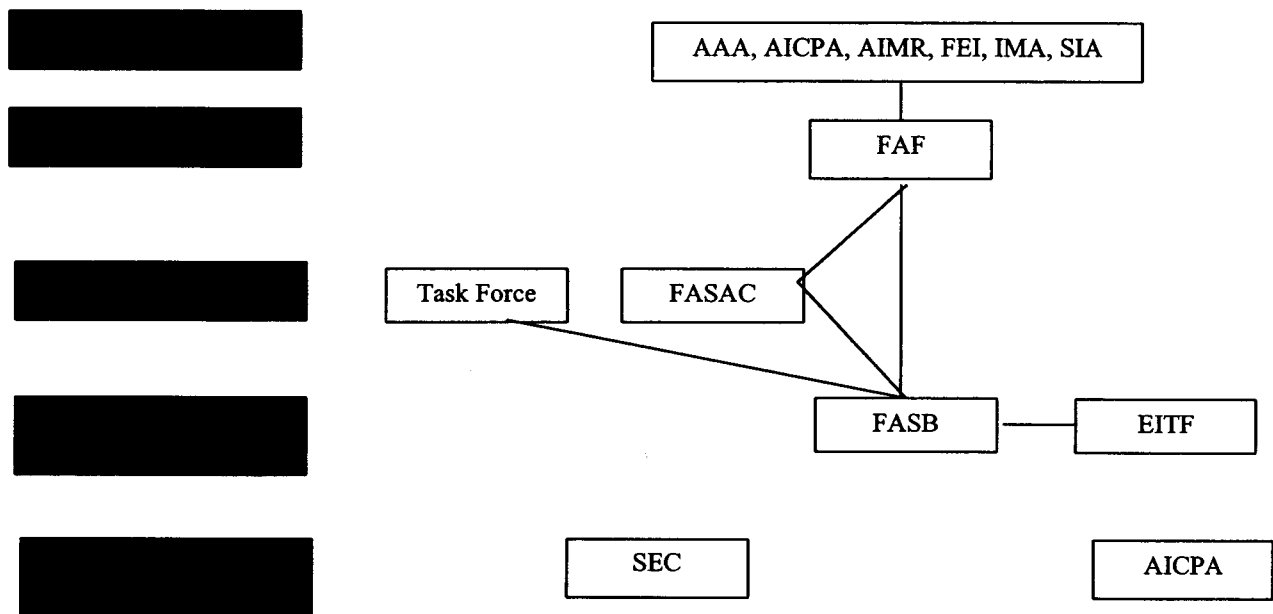
Financial Accounting Standards Board

In 1973, a new organization would succeed the Accounting Principles Board in the establishment of financial accounting and reporting standards. The organization would be called the Financial Accounting Standards Board. The FASB is an independent structure whose members are chosen by the Financial Accounting Foundation. Along with the member selections, the FAF also provides funding and general oversight to the FASB. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information (Rutgers 1). To accomplish its mission, the FASB must:

- ◆ Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency;
- ◆ Keep standards current to reflect changes in methods of doing business and changes in the economic environment;

- ◆ Promptly consider any significant areas of deficiency in financial reporting that might be improved through the standard-setting process;
- ◆ Promote international comparability of accounting standards concurrent with improving the quality of financial reporting; and
- ◆ Improve the common understanding of the nature and purposes of information contained in financial reports (Rutgers 1).

Standard-setting structure of the FASB



Unlike the MIPA who delegates the responsibilities for standard proposing and issuance, the FASB proposes as well as issues its standards. Approval of five of the seven members is needed. The standard procedure for developing an accounting standard is as follows:

1. Project identification-interested parties are solicited and a prospectus may be given
2. Creation of a task force-members are nominated
3. Preparation of a discussion document-analyze the problem, issues, and identifies possible solutions

4. Preliminary views-published by the FASB before the discussion document is published or after comments have been considered
5. Public hearing-can be after the issuance of the discussion document, preliminary views, or after the exposure draft
6. Exposure draft-issued and open for public comment over a 60 day period
7. Field test-the application of the proposed standard is tested while the exposure draft is open for comment
8. Final standard-results after the FASB has reconsidered all initial and recent issues

Hierarchy of Generally Accepted Accounting Principles

GAAP has only been in Mexico since the 1960's so its hierarchy is not made up of as many different pronouncements.

interesting

	Mexico	United States
Category A	Bulletins issued by MIPA	FASB Statements and Interpretations APB Opinions AICPA Accounting Research Bulletins
Category B	Circulars	FASB Technical Bulletins AICPA Industry Audit and Accounting Guides AICPA Statements of Position
Category C	International Accounting Standards	Consensus positions of the EITF AICPA AcSEC Practice Bulletins
Category D	Accounting principles of other countries-(U.S. GAAP used a lot)	AICPA Accounting Interpretations FASB Implementation Guides Widely recognized and prevalent industry accounting practices
Other	None	FASB Concepts Statements APB Statements AICPA Issues Papers IASB Standards GASB Statements, Interpretations, and Technical Bulletins Pronouncements of other professional associations or regulatory agencies AICPA Technical Practice Aids Accounting textbooks, handbooks, and articles

CERTIFICATION

Mexico

The specific requirements for achieving professional certification in the United States vary by jurisdiction but in Mexico it is a federal matter. Although the MIPA issues standards for accounting, auditing, ethical professional conduct, and continuing professional education, the General Directory of Professions establishes certification requirements. An individual must be a Mexican citizen to practice and become certified. Currently, there is no professional exam to attain certification but one must be a member of a Federada. Then, certification is automatic upon graduation from a university-level accounting curriculum (Evans 505). The accounting curriculums may vary slight from one university to the other but the general format requires eight semesters of classes centering around mathematics, cost and financial accounting, finance, and tax.

United States

The certification process in the United States is well developed and challenging. The Uniform Certified Public Accountants Exam is developed and administered under the direction of the AICPA. This two-day test is given twice each year, in May and November. It is administered in English and will only be graded if the answers are in English. All candidate grades are mailed on a uniform date, which is usually 90 days after the administration of the exam. In order successfully pass the CPA exam and gain certification, a candidate must receive at least 75 points on each section. The primary focus of the examination is to test on the knowledge and skills entry-level CPA's need to practice public accounting (AICPA 11). The CPA Exam will assess the understanding, application, and evaluation of a candidate's knowledge and skill. The exam is composed of four separate sections, each with questions formatted as

four-option multiple choice, other objective answer, and essay questions or problems. The timetable for each section is as follows:

Section	Hours	Day	Time
Business Law and Professional Responsibilities	3.0	Wednesday	9 a.m.-12 noon
Auditing	4.5	Wednesday	1:30 p.m.-6 p.m.
Accounting and Reporting	3.5	Thursday	8:30 a.m.-12 noon
Financial Accounting and Reporting	4.5	Thursday	1:30 p.m.-6 p.m.
Total	<u>15.5</u>		

The CPA Exam is non-disclosed; therefore the questions remain safeguarded after the exam. Since some questions may appear on future exams, candidates are required to sign confidentiality statements. Not disclosing the exam questions allow the enhancement of the exam quality because pre-test questions can be included and equating can be used. Pre-testing questions are scattered throughout the examination to assist in the determination as to which questions meet the quality standards and can be included in future exams. Equating is a statistical process that adjusts for the difficulty among test forms so that the scores are interchangeable.

CONCEPTUAL FRAMEWORK

The purpose of the conceptual framework is to present concepts relevant to the preparation and presentation of financial statements. Although their framework structures are different, Mexico and the United States are in conformity on its overall purpose.

UNITED STATES FRAMEWORK

FASB Concepts Statements

Objectives of Financial Reporting by Business Enterprises

Qualitative Characteristics of Accounting Information

Elements of Financial Statements

Objectives of Financial Reporting by Non-business Organizations

Recognition and Measurement in Financial Statements of Business Enterprises

MEXICO FRAMEWORK

Bulletins

Structure of the Basic Theory of Financial Accounting (A-1)

Definition of Basic Concepts Integrating Financial Statements (A-11)

Objectives of Financial Statements (B-1)

Financial Statements

Both frameworks share the same basic financial statements and agree that the objective of the financial statements is to provide users with information about an entity's financial position and results of operations. The Mexican framework also makes the observation that financial statements do not measure a company's human resources, products, trademarks, or markets (FASB 42). A set of basic financial statements consist of:

- ◆ The Balance Sheet or Statement of Financial Position
- ◆ The Income Statement
- ◆ The Statement of Changes in Stockholder's Equity or The Statement of Retained Earnings
- ◆ The Cash Flow Statement or Statement of Changes in Financial Position
- ◆ Notes to the Financial Statements

Many elements of the financial statements are also consistent between the two frameworks.

◆ Assets

◆ Liabilities

- | | |
|------------|--------------------|
| ◆ Equity | ◆ Income |
| ◆ Expenses | ◆ Gains |
| ◆ Losses | ◆ Profits/earnings |

One difference worth mentioning exists in the definitions of these elements. The Mexican framework defines the difference between an expense and a loss based on whether revenue was generated. An expense gives rise to revenue generation whereas a loss does not.

Similar to the 10K annual report of U.S. companies, a Mexico company must attach the auditor and management reports to the financial statements and present them at the annual stockholders' meeting. Companies listed on the National Securities Commission must publish their financial statements and their auditor's report in a major newspaper but companies that are not listed are not required to make their statements available for public inspection.

Assumptions

Both frameworks use accrual basis and going concern as their underlying assumptions. The accrual basis allows for transactions and other events to be recognized when they occur and going concern permits the assumption that an entity is able to continue operations in the foreseeable future unless the financial statements show otherwise. The concept of deferrals is not mentioned in the Mexican framework but it does refer to provisionality as an assumption. Provisionality is the fact that the financial information provided does not represent completely terminated transactions, because financial statements cover a specific period of time and not the complete operating cycle of an entity (FASB 43).

Qualities and Characteristics

Although importance may vary and there may be minor differences in definition and interpretation, the Mexico and United States frameworks share the same qualities and

characteristics, such as relevance, reliability, comparability, consistency, timeliness, and representational faithfulness, recognition, and historical cost measurement. Some of the key differences in the definitions and interpretations of certain qualities and characteristics are:

Relevance—In the U.S. framework, relevance is the capacity of accounting information to influence the decisions of investors, creditors, and other users by helping evaluate the financial impact of past, present and future transactions or events. The Mexican framework defines relevance as the quality of selecting information that will help users to understand the message of the information and use it to achieve their specific goals.

Reliability—The Mexican framework concludes that users and not financial information determine reliability.

Materiality—While the U.S. framework places an emphasis on whether materially misstated financial statements could influence a decision, the Mexican framework emphasizes the importance of the information's usefulness and purpose, not its influence.

Signification—This concept is only referred to in the Mexican framework. It deals with the ability to represent with words and amounts, the entity and its evolution, its status at different points in time, and its results of operation (FASB 44).

SIGNIFICANT ACCOUNTING DIFFERENCES

Inflation adjustments

Mexico: Under Mexican GAAP financial statements must recognize the effects of inflation where as inflation methods of accounting does not follow U.S. GAAP. Originally Bulletin B-10 of the MIPA, recommended the use of general price level adjustments for all companies and specific price valuation for fixed assets and inventory for firms with publicly traded securities. As a means of working toward international harmonization, a fifth amendment (January 1996) to Bulletin B-10 established the general price level adjustment as the sole method of accounting and permitted note disclosure of specific prices (Radebaugh 68). The current peso-purchasing power at the balance sheet date is used to measure the general inflation rate. As the devaluation of the peso continues to have great effects on the economy and inflation rates continue to fluctuate, Mexico must maintain its methods of inflation-adjustment reporting.

United States: In the 1970's and early 1980's the U.S. had to resort to inflation accounting as inflation continued to rise way above normal. As the 1980's drew to a close, inflation rates began to fall and eventually stabilize. With this, the need to report using inflation accounting vanished.

Deferred Taxes

The determination of some book and tax variances differ between Mexican and U.S. GAAP:

Item	Mexico tax treatment	U.S. tax treatment
Cost of sales	Inventory items are deducted when purchased	Inventory is deducted when used/sold
Depreciation	Deductible at maximum under straight-line	Depends on depreciation method adopted
Amortization of good will	Not deductible for tax	Deductible based over estimated life or over 40 years-which ever shorter
Interest and exchange losses	Deductible after subtracting inflationary gain	N/A
Provisions for accrued or estimated expenses	Only definite amounts due to specific creditors may be deducted	Expenses may be deducted when accrued
Provisions for pensions and other seniority benefits	Deductible only when calculated on an actuarial basis and paid to an irrevocable trust	Deductible when paid
Bad debts	Deductible when inability to collect can be established or statute of limitations to demand payment has expired	Deductible when collection is not feasible

Obsolete merchandise	No relevancy because no inventory is kept for taxes purposes-inventory is deducted as purchased	N/A
Adjustments for inflation	Adjustment vary for tax and book based on a variety of factors	No inflation adjustments are made

Intention

Mexico: Under Mexican GAAP temporary differences only need to be noted in the financial statements. The recognition of deferred tax results when a deferred tax liability or asset is generated in a definite time period. Unlike U.S. GAAP, in Mexico there is no deferred tax provision for recurring temporary differences that are expected to reverse in the future. An example of a reversal would be when accelerated depreciation is used for tax purposes and straight-line is used for book reporting. There will be a credit to the deferred tax account when the difference originates and a debit to the account when it reverses in the future.

United States: In accordance with U.S. GAAP, deferred taxes are to be reflected in the basic financial statements.

Pensions and Post-retirement benefits

Mexico: Funding of pension liability is not disclosed in the financial statements or notes. If pension requirements can be reasonably estimated they are charged to earnings. If they cannot be reasonably estimated, then they are not included as a pension obligation.

United States: Pension expense for the period, prepaid/accrued pension cost, and the minimum pension liability are reported on the employer's balance sheet but the assets and liabilities of the pension trust are not. The trust fund records are separate from the balance sheet.

Leases

Mexico: Guidelines for lessee/lessor lease classification are similar to those of the U.S. but they lack the specificity and detail of U.S. GAAP (Fitzsimons 40).

United States:

	Lease Type	Criteria
Lessee	Capital	Must be non-cancelable and <i>One of the following:</i> Transfer of ownership Bargain purchase option Lease term is greater than or equal to 75% of economic life Present value of minimum lease payments are greater than or equal to 90% Fair market value of leased property
	Operating	All leases that do not qualify as a capital lease
Lessor	Direct financing and Sales type	Lessee capital lease criteria and both of the following: Collection of lease receivable is not in doubt No important uncertainties concerning the amount of unreimbursable costs still to be incurred * Income is interest income-direct financing * Interest income recorded over lease term and gross profit on sale recorded in year of sale-sales type
	Operating	All leases that do not qualify as a direct financing or sales type lease

Research and Development

Mexico: If future benefits and expected periods of recovery cannot be determined, R&D costs are expensed and disclosed.

United States: R & D costs are always expensed and disclosed on the face of the income statement or in the footnotes.

Capitalization of interest

Mexico: All interest can be capitalized and must be adjusted for the effects of inflation.

United States: In order for interest to be capitalized expenditures for the asset have to be made, activities to get the asset ready for use are in progress, and interest costs are being incurred.

Interest cannot be capitalized for routinely produced inventories, assets ready for their intended use when acquired, assets not being used or readied for use, or land that is not being developed.

Securities

Mexico: If securities are frequently traded, they are carried on the books at market value less selling cost. If the securities are not traded often, they are carried at cost. Declines in portfolios' market value are included in the income statement. The equity method is used for when 25% to 50% of investee's shares

United States: Securities are classified into three categories:

Held-to-maturity—Debt securities that the company has the positive intent and ability to hold until maturity. They are reported on the balance sheet at amortized cost and are not adjusted for temporary market value changes.

Trading—Debt and equity securities that are held for the purpose of selling in the near future. They are reported at fair market value as of the balance sheet date.

Available-for-sale—Debt and equity securities that do not fit into the two previously mentioned categories. They are reported at fair market value as of the balance sheet date.

The equity method is used when the investor has significant influence or control over investee, which is usually 20% or more of the investee's voting shares.

Inventory

Mexico: Inventory is valued based on the lower of market value or current cost. Either the last purchase price, last production cost, FIFO cost flow, or historical cost based on the purchasing power of the peso can be used in the determination of current cost. FIFO, LIFO, average cost, specific cost, and standard cost are all allowable methods of inventory valuation.

United States: Inventory is carried at the lower of cost or market. LIFO, FIFO, or weighted average valuation can be used.

Fixed Assets

Mexico: A price level index is used to determine the market value of fixed assets and then they are recorded at the market value less depreciation. Land can be reported at current value, appraised value or price-level adjusted historical cost. Whichever approach is used should be disclosed in the notes.

United States: Fixed assets are carried at cost less depreciation. How fixed assets are carried and the methods of depreciation used should be disclosed in the notes to the financial statements under significant accounting policies.

Intangibles

Mexico: Negative goodwill is presented as a component of stockholders equity and is not amortized. Other intangibles are amortized over the lesser of period benefited or 20 years.

United States: Intangibles are amortized over the lesser of the estimated useful life or 40 years.

Negative goodwill from an acquisition

Mexico: Can be deferred and amortized over no more than five years.

United States: Long-term assets are first reduced by negative goodwill and the remaining negative goodwill is amortized.

Business Combinations

Mexico: If the acquired company's shareholders do not maintain an equity interest after a merger, it is treated as a purchase. If an equity interest is retained, then the pooling method is used.

United States: The pooling of interests method is only used if specific criteria are met.

Consolidations

Mexico: Less than majority owned subsidiaries may be consolidated but if a company owns over 50% of a subsidiary then consolidation must be carried out.

United States: Only majority owned subsidiaries might be consolidated.

Earnings per Share

Mexico: The earnings per share denominator is based on year-end shares and need not be disclosed.

United States: The earnings per share denominator is based on average outstanding shares at year-end and earnings per share must be disclosed on the income statement or in the notes.

Foreign Currency Transactions and Translations

Mexico: Current rate is used to translate financial statements and translation gains and losses are recognized on the income statement.

United States: Financial statements are translated according to the U.S. dollar equivalent at the balance sheet date. The translation adjustment goes to other comprehensive income and then to accumulated other comprehensive income.

Segment reporting

Mexico: There is no standard concerning segment reporting.

United States: Segment industry and/or geographical information is required.

Financial issues that are not addressed in Mexico GAAP

- ◆ Recording of an acquired entity's deferred income taxes
- ◆ Push-down accounting
- ◆ Expenses related to the pooling of interests method
- ◆ Transfers between entities under common control

- ◆ Joint ventures
- ◆ Capital assets used in R&D projects
- ◆ Computer software costs

For areas in which Mexico has no standards, International Accounting Standards are currently being used.

CONCLUSION

There are similarities between the FASB and the MIPA such as independence from government, accounting standard development without income tax law considerations, and the presence of a conceptual framework but naturally there will also be differences. FASB members work full-time and they are assisted by full-time staff whereas the APC members work on a voluntary basis. These elements will affect the political environment in which the standard-setting bodies operate and the scope, depth, and speed with which they are able to carry out their activities (Luscombe 15). The strong influences of GAAP and the desire of attaining reciprocity has the MIPA motivated to move toward harmonization in financial reporting and certification requirements. It is not impossible but it will be difficult. An abundance of time and effort will be required but every accomplishment is a step toward more compatible reporting and more incentives to operate on a global level.

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Fine job -
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