A SURVEY OF TRANSFER PRICING PRACTICES OF COMPANIES IN SELECTED INDUSTRIES ON BURSA MALAYSIA

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ABSTRACT

This paper is basically a survey of the transfer pricing practices of firms in selected industries on Bursa Malaysia. In our survey, we have looked at the transfer price methods that are commonly used by firms. It also looked into the important factors that influence the design and operation of the transfer pricing system and if there are any differences between firms size and age and between service and non-service industries. The results showed that the popular methods used are the actual cost to produce and process goods and/or services to the point of transfer and external market price of similar competing goods. Majority of the firms that did not practice transfer pricing gave insignificant volume of interdivisional transfer in the firm as their reason. This is in line with the study conducted by McGaughey (1997). Majority of the firms in the survey stated that their transfer pricing methods are similar to other firms. Return on investment, profit and firm's growth and taxes are the important factors considered by firms in establishing transfer prices. The findings indicated the overall importance of transfer pricing objectives of firms is not associated with firm's size and age. Overall, there is no significant relationship between the extent of managers' involvement at various levels with size and age of firms and whether it is a service or non-service firm.

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CHAPTER ONE

INTRODUCTION

1.0 OVERVIEW AND DEFINITIONS

In large organizations, it is difficult for central management to monitor and control operations on a regular basis. Due to this, most large organizations are decentralized into sub-units or divisions. Each division is given a measure of autonomy, allowing the manager to exercise freedom in making decisions. In order to measure the performance of each division, a method is required for measuring the contribution of each division to the total profit of the organization. A common solution to this is to set prices for intermediate goods or services which are transferred from one division to another. These prices are known as transfer prices.

Hilton (1999), defines transfer pricing as the amount charged when one division sells goods or services to another division. The price will affect the profit for both the selling and buying division. A high transfer price results in high profit for the selling division and low profit for the buying division. A low transfer price will have the opposite effect. Hirshleifer (1956) defines transfer pricing as a maximization problem where the optimal solution is achieved when the marginal cost of the selling division equals the marginal gross profit of the buying division.