# FASB NO. 8--A MORE MEANINGFUL STATEMENT

AN HONORS THESIS (ID 499)

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## Introduction

Much has been written in the past about the translation of foreign financial statements and the problems it has presented. It would be much easier if the American multinational firms would convert their assets and liabilities from the foreign currency to United States dollars. By physically exchanging one currency unit for another, the firms would know the exact net worth of their foreign entities. This is not practical, so at the end of each period the foreign statements are translated. The purpose of the translation is to change the monetary expressions of the foreign assets, liabilities, revenue, and expenses as though they had been measured and recorded in dollars under American generally accepted accounting principles.

Many translation methods evolved to present actual results of foreign operations while conforming with the accounting procedures. Under previously fixed exchange rates, the various methods produced similar results. The value of individual currencies was expressed in terms of gold and "pegged" to a convertible dollar. Foreign currencies could only fluctuate by 1% up or down against the dollar. With the fixed rates in effect, the risk of translation was relatively limited. In the early 1970's the system of fixed exchange rates was replaced by the floating rate system. Now the various translation methods change considerably with no uniformity. For instance, under devaluation, the current-noncurrent and the current rate methods of translation produce exchange losses while the monetary-nonmonetary and the temporal methods produce exchange gains. The accounting profession argues that these losses and gains are produced by conventional translation methods that stress practical measurement and disclosure practices instead of economic reality.

Are the accounting practices reflecting or distorting the economic substance underlying the financial results of foreign operations? The conventional translation methods are accused of creating an accounting reality which induces American multinational firms to overmanage the risks of foreign currency translation. Firms are tempted to reduce exposure to translation adjustments by increasing their cash borrowings. The costs incurred to avoid the exposure are more detrimental to the firms' profits than the exposure, itself.

Under the fixed exchange rate system, there was no need to be concerned with the management of the exposure to translation since it had little impact on reporting the results of foreign operations. The floating exchange rate system allows the translation exposure to have a significant impact on reported earnings. Today's shifting economy, created by floating rates, calls for a re-evaluation of the various translation methods to determine their ability to resolve the problems of increased international business activity, extensive currency adjustments, and new accounting procedures. The intent of this paper is to provide insight to the different techniques and to select a translation method that will best reflect today's changing environment.

## Survey of Literature

### Translation Methods

#### Current-Noncurrent Method

The current-noncurrent method was acknowledged as the first proper practice for translating foreign financial statements with the issuance of ARB No. 43. The translation of current assets and current liabilities at the exchange rate in effect at the balance sheet date was established by Chapter 12 of this bulletin. All other assets, liabilities, and equities were to be translated at the historical rates prevailing when they were incurred.

> The practice of translating noncurrent items at historical rates served several purposes. The dollar value of property, plant, and equipment was not felt to be diminished by the devaluation as long as operations continued because the devaluation usually reflected severe inflationary conditions locally. Use of historical rates for long-term liabilities held to the principle of conservatism. Any gain resulting from the rate change was deferred in this manner until the liquidation of a liability.[1]

The current-noncurrent method treated property, plant, and equipment as having intrinsic value which did not change with devaluation. The accounting profession felt the failure to treat inventory in this same manner represented a departure from the historical cost concept; therefore, the monetary-nonmonetary method evolved.

Monetary-Nonmonetary Method

In 1965, APB Opinion No. 6 was issued to provide a method to translate assets and liabilities upon their characteristics, rather than upon their balance sheet classification. Those assets and liabilities representing claims or obligations expressed in a fixed monetary amount are translated at the current exchange rate. All other assets, liabilities, and owners' equity accounts are translated at the appropriate historical rates. Under this method, inventory is translated at historical rates since it is a nonmonetary asset. The other change occurred with noncurrent payables and receivables. Without specifying the circumstances, Paragraph 18 of APB Opinion No. 6 found translation of these accounts at current rates is appropriate in many instances.

The monetary-nonmonetary method retains the historical concept in foreign financial statements, which makes accounting standards applied in consolidated or combined statements more consistent. Under this method, changes in resources, obligations, and operating results of a foreign subsidiary are stated as though they occurred in the parent company's currency. Although this method corrected

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[1]Ruth E. Pleak, "An Analysis of the FASB's Treatment of Foreign Currency Translations," Management Accounting, Vol. 59, September 1977, p. 31.

problems of the current-noncurrent method, it created a new problem in the determination of the dominant characteristic of some assets and liabilities. The temporal method evolved to answer the question.

Temporal Method

In 1972, ARS No. 12 recommended a new method of translation which would be more compatible with the historical cost framework of accepted accounting principles. This method is a slight modification of the monetary-nonmonetary method. It calls for the translation of assets and liabilities accounted for at present or future prices at the current exchange rate, while those assets and liabilities carried at past prices are translated at applicable historical rates.

Much of the confusion created by the monetary-nonmonetary system was eliminated. The noticeable changes occur in inventory and investments. The inventory and investment accounts that are carried at cost are translated at historical rates. The inventory and investment accounts recorded at market value are translated at current rates.

Current Rate Method

This method has not been generally accepted by the United States. The FASB rejected it in the Proposed Statement of Financial Accounting Standards on Foreign Currency Translation in 1974. Most of the support of this method comes from foreign entities. Today, it is gaining more support, especially from the critics of the other translation methods. The current rate method, unlike the other techniques, emphasizes the local currency aspects of foreign subsidiaries. It best reflects the actual financial position of foreign operations.

All assets and liabilities are translated at the current exchange rate. Owners' equity accounts are translated at appropriate historical rates. A

minority of accountants believes that the translation of owners' equity should also be at the current rate.

## Translation Methods Compared and Contrasted

In the income statement, depreciation and amortization are translated at historical rates under the current-noncurrent, monetary-nonmonetary, and temporal methods. Cost of goods sold is translated at the appropriate rate used to translate the inventory; this may be either current or historical rates. Historical rates are used to translate the remainder of the revenue and expense accounts. Average rates may be used since it is often difficult and costly to keep record of these transactions. Under the current rate method, all expenses and revenues are translated at current rates.

The income statement is treated similarly with respect to all methods. The methods differ primarily in translation of the balance sheet accounts. Table 1 summarizes the differences of the four methods.

## Exchange Gain and Loss Treatment

Under each different method, items in the financial statements are translated at several rates--current, average, and historical. The use of these different rates produces an imbalance of debits and credits. A balancing figure labeled as an exchange gain (loss) is produced to reconcile the difference. This gain (loss) has been treated in several different manners.

### Immediate Recognition

This technique is the simplest. There is no record keeping of deferrals of the exchange gains or losses since they are entirely recognized in the immediate period. With the full recognition of the exchange gains and losses, a greater fluctuation from period to period in net income will result.

TABLE 1

SUMMARY OF TRANSLATION METHODS

| | Current-Noncurrent | Monetary-Nonmonetary | Temporal | Current Rate |
|---|---|---|---|---|
| Cash . . . . . . . . . . . . | C** | C | C | C |
| Accounts Receivable . . . . | C | C | C | C |
| Inventory: | | | | |
| Cost . . . . . . . . . . . | C | H** | H | C |
| Market . . . . . . . . . . | C | H | C | C |
| Investments: | | | | |
| Cost . . . . . . . . . . . | H | H | H | C |
| Market . . . . . . . . . . | H | H | C | C |
| Fixed Assets . . . . . . . . | H | H | H | C |
| Other Assets . . . . . . . . | H | H | H | C |
| Accounts Payable . . . . . | C | C | C | C |
| Long-term Debt . . . . . . | H | C | C | C |
| Common Stock . . . . . . . . | H | H | H | H |
| Retained Earnings . . . . . | * | * | * | * |

*Residual Balance
**Current Rate (C), Historical Rate (H)

Defer Gain--Recognize Loss

This technique is the most compatible with the concept of conservatism. Therefore, gains are not recorded until they are realized. Technically, no gain is realized under translation; it is realized under conversion. A gain may be recognized to the extent that it offsets other exchange losses; then the remainder is deferred. Exchange losses, or the remainder exceeding the gains, are recognized immediately.

Defer Gain and Loss

Under this technique, both gains and losses are deferred. The net is then amortized over some smooth long-run average basis. Fluctuations in net income would develop primarily from adjustments to the amortization rates, not from varying currency exchange rates. This technique is more judgmental than the others since each entity would determine an amortization rate to be used for the deferral.

Hodge-Podge Methods

These methods evolved from the combination of the prior techniques. A method recommended by Chapter 12 of ARB No. 43 called for the recognition of exchange losses and realized exchange gains immediately in net income while unrealized exchange gains would be deferred to the extent that they offset the losses. In 1971, the APB proposed another method in the exposure draft entitled, "Translating Foreign Operations". This technique was compatible with the monetary-nonmonetary system and required an entity to ". . . defer exchange gains and losses to the extent that they did not exceed those attributable to long-term debt. Amounts deferred were to be accounted for in a similar to debt discount."[2]

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[2]"Translating Foreign Operations," exposure draft, December 20, 1971, quoted in "Statement of Financial Accounting Standards No. 8--Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements," The Journal of Accountancy, December 1975, p. 87.

FASB #8

The different methods used for translation of foreign financial statements led to confusion as more companies became multinationals. There was no consistency among statements; there was no basis for comparison. In order to correct this matter, FASB No. 8, "Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements", was released in October 1975.

## The Purpose of Statement No. 8

Statement No. 8 established standards of financial accounting and reporting for foreign currency transactions plus foreign currency financial statements that were combined or consolidated with the statements of an American reporting enterprise. For the purpose of preparing combined or consolidated financial statements, FASB #8 selected a translation method with the objective of measuring and expressing the assets, liabilities, revenue, or expenses, which were measured or denominated in foreign currency, in dollars and in conformity with U. S. generally accepted accounting procedures. The purpose of this statement was to select a translation method that remeasured the foreign currency accounts in dollars without altering the measurement bases required by other accounting principles.

## The Requirements of Statement No. 8

Statement No. 8 requires the American multinational firms to adopt a modified temporal method for translation of foreign financial statements. Table 2 summarizes the rates to be used in translating the balance sheet items. The exchange gains or losses resulting from translation are to be recognized entirely in the immediate period; there are no deferrals.

TABLE 2

RATES USED TO TRANSLATE ASSETS AND LIABILITIES

| | Translation Rates | |
|---|---|---|
| | Current | Historical |
| Cash on hand and demand and time deposits | X | |
| Marketable equity securities | | |
| Carried at cost | | X |
| Carried at current market price | X | |
| Accounts and notes receivable and related unearned discount | X | |
| Allowance for doubtful accounts and notes receivable | X | |
| Inventories: | | |
| Carried at cost | | X |
| Carried at current replacement price or current selling price | X | |
| Carried at net realizable value | X | |
| Carried at contract price (produced under fixed price contracts) | X | |
| Prepared insurance, advertising, and rent | | X |
| Refundable deposits | X | |
| Advances to unconsolidated subsidiaries | X | |
| Property, plant, and equipment | | X |
| Accumulated depreciation of property, plant, and equipment | | X |
| Cash surrender value of life insurance | X | |
| Patents, trademarks, licenses, and formulas | | X |
| Goodwill | | X |
| Other intangible assets | | X |
| Liabilities | | |
| Accounts and notes payable and overdrafts | X | |
| Accrued expenses payable | X | |
| Accrued losses on firm purchase commitments | X | |
| Refundable deposits | X | |
| Deferred income | | X |
| Bonds payable or other long-term debt | X | |
| Unamortized premium or discount on bonds or notes payable | X | |
| Convertible bonds payable | X | |
| Accrued pension obligations | X | |
| Obligations under warranties | X | |

SOURCE: "Statement of Financial Accounting Standards No. 8--Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements," The Journal of Accountancy, December 1975, p. 84.

## The Response to FASB No. 8

Overwhelming criticism emerged when this statement was issued. At first, the criticism focused on the methods selected to translate foreign statements and to report the foreign currency adjustments. Prior to the statement, only one out of three American firms used the temporal method. Approximately 70 percent of the American firms used some form of deferral to prevent erratic fluctuations to the income statement caused by translation adjustments.

Today, criticism focuses on required disclosure of the statement. John K. Shank and Gary S. Shamis expressed the following opinion in their article on foreign currency translation.

> GAAP requires that disclosures be adequate to ensure a full and fair presentation of the financial situation. A question can be raised as to whether the required disclosures under statement no. 8 measure up to this standard. This is a particularly crucial question in an area such as foreign currency accounting where extensive disagreement on basic objectives and worldwide diversity in accounting practices make full disclosure even more important than is normally the case. Full disclosure of the impact of foreign exchange rate swings on the consolidated financial statements enables the reader to make whatever adjustments are deemed necessary in terms of the conceptual framework selected by the user."[3]

Critics are demanding more disclosure. They want disclosure of statements that reflect economic reality. Does FASB No. 8 reflect economic reality or is it creating a new reality? The goal of proper accounting is to reflect actual results of the business entities. The profession questions whether this statement reflects reality when it translates foreign operations from a parent company's point of view. Translated results and relationships, under this modified temporal method, differ significantly from those reflected in the foreign currency statements. The accounting profession is focusing its attention to these criticisms.

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[3]John K. Shank and Gary S. Shamis, "Reporting Foreign Currency Adjustments: A Disclosure Perspective," The Journal of Accountancy, Vol. 147, April 1979, p. 59.

More Disclosure of Exchange Gain/Loss

Statement No. 8 requires that all foreign exchange gains and losses be reported in the income statement immediately--only the aggregate amount needs to be disclosed. This does not seem to present full disclosure. John K. Shank notes that there exists three different types of exchange gains and losses having significantly different implications.

Realized Gains and Losses. These are gains and losses resulting from a closed exchange in which a transaction is settled at a rate different from the rate used to record the carrying value of items. The transactions are completed. There is no question as to whether the gain or loss is "real" and should be recognized.

Unrealized Gains and Losses. These gains and losses result from an open exchange which is a transaction involving two currencies that has not been settled at the end of the period. The exchange rate, at the time the transaction is completed, is unknown. Under this open exchange, the gain or loss is not realized. By the time the transaction is closed it may have reversed or increased. FASB No. 8 still requires the immediate recognition of the unrealized gain or loss.

Translation Gains and Losses. This third type of exchange gain or loss arises when the conversion rates used to translate successive balance sheets of a foreign entity are different. The debits and credits will not be equal when the successive balance sheets are translated into equivalent dollars at the different exchange rates. A balancing figure is created to account for the difference. "This figure can always be rationalized or explained as the product of the parent's net 'exposure' position to fluctuations in the subsidiary's currency multiplied by the percentage change in the exchange rate."[4] Examination of Exhibits 1,

[4]Ibid., p. 60.

EXHIBIT 1

1979 Income Statement

| | Foreign Currency | Dollars-FASB #8 | Assumptions |
|---|---|---|---|
| Sales | FC 2000 | $1800 | Revenues accrued ratably over the year - no seasonal effect. |
| Interest Income | 600 | 540 | |
| Total Revenue | FC 2600 | $2340 | |
| Cost of Goods Sold (FIFO) | 800 | 880 | Represents inventory purchased in equal amounts each month during 1978. |
| Depreciation | 500 | 600 | Depreciation on plant acquired when the exchange rate was FC 1 : 1.2. |
| Selling & Administration | 300 | 200 | Accrued ratably over the year. |
| Other Expenses | 400 | 360 | " " " " " |
| Profit Before Taxes | FC 600 | $ 230 | |
| Income Tax | 300 | 270 | Paid monthly. |
| Net Income | FC 300 | $(40) | |

Exchange Rates

| | | | |
|---|---|---|---|
| January 1, 1978 | FC 1 : 1.2 | Average Rate 1978 | FC 1 : 1.1 |
| January 1, 1979 | FC 1 : 1.0 | Average Rate 1979 | FC 1 : .9 |
| January 1, 1980 | FC 1 : .8 | | |

2, and 3 should clarify the definition of translation gains and losses.

In Exhibit 3, a translation gain of $750 was computed, but what is its significance? If this foreign subsidiary and the parent company continually make regular transactions exchanging the foreign currency for dollars, then the gain is real. If the foreign subsidiary conducts all of its transactions locally,

EXHIBIT 2

### 1979 Balance Sheet

| | Foreign Currency | Dollars-FASB #8[a] |
|---|---|---|
| Cash | FC 700 | $ 560 |
| Accts. Rec. | 1100 | 880 |
| Inventory (FIFO) | 1200 | 1080[b] |
| Plant & Equipment | 6000 | 6750[c] |
| Land | 2000 | 2400[d] |
| Total Assets | FC 11,000 | $ 11,670 |
| Accts. Pay. | FC 1100 | $ 880 |
| Notes Pay. | 1200 | 960 |
| Bonds Pay. | 2100 | 1680 |
| Mortgage Pay. | 1700 | 1360 |
| Common Stock | 3500 | 4200 |
| Add. Paid-In Cap. | 500 | 600 |
| Retained Earnings | 900 | 1990 |
| Total Liab. & Capital | FC 11,000 | $ 11,670 |

### 1978 Balance Sheet

| | Foreign Currency | Dollars |
|---|---|---|
| Cash | FC 600 | $ 600 |
| Accts. Rec. | 1000 | 1000 |
| Inventory (FIFO) | 800 | 880 |
| Plant & Equipment | 5000 | 6000 |
| Land | 2000 | 2400 |
| Total Assets | FC 9,400 | $ 10,880 |
| Accts. Pay. | FC 800 | $ 600 |
| Notes Pay. | 1000 | 1000 |
| Bonds Pay. | 2000 | 2000 |
| Mortgage Pay. | 1000 | 1000 |
| Common Stock | 3500 | 4200 |
| Add. Paid-In Cap. | 500 | 600 |
| Retained Earnings | 600 | 1280 |
| Total Liab. & Capital | FC 9,400 | $ 10,880 |

[a]Refer to rates used in Exhibit 1.
[b]Inventory was purchased each month during year.
[c]Plant & Equipment:

| | |
|---|---|
| $ 4500 | Purchased when rate was FC 1 : 1.2 |
| 1500 | Purchased equal amounts in each month when rate was FC 1 : .9 |
| $ 6000 | |

[d]Land was purchased when exchange rate was FC 1 : 1.2

EXHIBIT 3

## Computation of Translation Gain

Exposure*

| | 1979 | 1978 |
|---|---|---|
| CL | 6100 | 4800 |
| CA | 1800 | 1600 |
| | 4300 | 3200 |

| | |
|---|---|
| 1979 Net Liability Exposure | 4300 |
| 1978 Net Liability Exposure | 3200 |
| Change in Exposure in 1979 | 1100 |

Translation Gain**

| | | |
|---|---|---|
| Exposure throughout the year times full year's devaluation | (3200 x 20%) | 640 |
| Change in exposure during year times one-half year's devaluation | (1100 x 10%) | 110 |
| Total Translation Gain | | 750 |

OR

| | |
|---|---|
| 1979 Translated Retained Earnings | 1990 |
| 1978 Translated Retained Earnings | 1280 |
| | 710 |
| 1979 Net Income (Loss) | (40) |
| Total Translation Gain | 750 |

*Exposure to translation gain or loss equals the net of the accounts translated at current rates.

**Translation gain or loss equals exposure times the percentage of devaluation.

then this gain is meaningless. It makes no difference how many dollars resulted from the translation if there is no intercurrency exchanges in the foreseeable future. This gain would be unrealized.

### More Disclosure of Exchange Gain/Loss Before and After Taxes

FASB No. 8 does not require any disclosure of the effect taxes have on

exchange gains and losses. This impact is not always clear according to Shank and Shamis, who uncovered the following examples. In 1975, Tenneco reported an exchange gain of $2 million before taxes and reported an exchange loss of $1 million after taxes. On the other hand, International Paper had an exchange loss of $1,100,000 before taxes and an exchange gain of $200,000 after taxes in 1976. It seems that more disclosure of the income tax impact on exchange gains and losses would be necessary.

More Disclosure of Gross Margin Distortion

By translating inventories at historical rates, there is a mismatch of revenue and expense. Cost of goods sold contains an element of the realized gain or loss on foreign inventories sold during the period. This can be seen by referring back to Exhibits 1 and 2. Inventory was bought for $800 when the exchange rate was FC 1 : 1.1. It was sold in 1979 for $2000 when the rate was FC 1 : .9. Under this method, there is a gross margin of $920; yet, part of this margin resulted from a realized gain of $160 from holding the goods when they devalued from $880 to $720. There is no disclosure to distinguish results of operations and results of translation.

## The Solution to FASB #8

"The public expects of financial statements that any loss or gain reported in net income is identifiable with a discernable corresponding change in economic worth of the company's resources."[5] In the past the arguments centered on shallow explanations used to defend the modified temporal method. FASB #8 is accused of using prior labels without studying their full impact on translation. It is hoped that this proposed, alternate method can better report the actual

[5]Marvin Deupree, "Is FASB #8 the Best Approach?," Financial Executive, Vol. 46, January 1978, p. 26.

operations of foreign entities and clarify those areas where confusion exists.

## Current Rate Method

Statement No. 8 was adopted by six affirmative votes of the Financial Accounting Standards Board. Mr. Mays, the seventh member, dissented. He dissented because he felt the temporal method was inappropriate for translation. Mr. Mays supported the current rate method because he felt it met two requirements deemed essential:

> . . . (1) that the translation process should preserve the essence of the foreign currency statements in terms of financial position and results of operations and (2) that it should produce results that are generally consistent with the economic effects of exchange rate changes.[6]

By translating financial statements from an ongoing foreign currency perspective, the current rate maintains the characteristics of the foreign operations. The temporal method misstates actual results by translating assets, liabilities, revenue, and expenses as though they had individually been transacted and recorded in dollars. Mr. Mays felt that all assets are equally at risk in the foreign exchange market, not individual assets acquired by the foreign subsidiary.

## No Distortion of Relationships

The greatest weakness of the temporal method and the greatest strength of the current rate method lies in the relationship of the items in the financial statements. By referring back to Exhibits 1 and 2, it is possible to see the distortion of financial ratios after translation by the temporal method. The ratio of sales to fixed assets before translation is .25, while it is .20 after translation. Net income to net sales before translation is .15; it is (.02) after translation. The current rate method maintains these ratios.

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[6]"Accounting Standards No. 8," p. 83.

No Mismatching Revenue and Expense

Cost of goods sold retained a portion of realized gain ($160) by translating inventory at historical cost. The mismatching arises from translating inventories and fixed assets at historical rates while translating the short- and long-term debt, used to finance them, at current rates. It was generally accepted that the temporal method was superior because it was the most compatible with the historical cost concept. Mr. Mays stated in his dissenting opinion that ". . . assets acquired for local currency by a foreign subsidiary have no historical dollar cost; their historical cost exists only in local currency, and translation at the current rate does not change that basis."[7] By adopting the current rate method, characteristics of items are maintained without mismatching revenue and expense.

A Word of Caution

There are discrepancies under the current rate method. The vast majority of the accounting profession translate all items in the balance sheet, except owners' equity, at the current rate. Owners' equity is translated at historical rates. Under this variety of the current rate method, some ratios will remain distorted. A minority of accountants adopt the position that owners' equity should also be translated at the current rate. It was stated before that historical cost only existed in the local currency. Therefore, it would seem logical to translate owners' equity at the current rate.

Immediate Recognition with Disclosure

There is a significant argument against immediate recognition of exchange gains and losses. Under the concept of conservatism, all gains and losses would be recognized, except unrealized gains. These would be deferred. Statements be-

[7]Ibid., p. 83.

come more judgmental by using deferrals. If the change in rates is permanent, then the company is delaying the inevitable. By recognizing the entire exchange gain or loss and then disclosing the different aspects of it, the reader is able to determine the significance of the gain or loss.

### Disclosure of the Types of Exchange Gains and Losses

It was discussed earlier that three types of exchange gains and losses exist--realized, unrealized, and translation. By using the definition of the current-noncurrent concept, the realized and unrealized portions can be determined. Since current asset and liability transactions are normally closed within one year, the devaluation or revaluation of these items is realized. Devaluation or revaluation of the remaining items would be unrealized. There is no translation gain or loss when the current rate is used to translate all items, including owners' equity, in the financial statements.

### Disclosure in Statements

The unrealized and realized portions of the exchange gain or loss should be disclosed in the body of the income statement. These portions should be disclosed before and after taxes, since income tax can greatly influence the results.

### Disclosure in Footnotes

The significance the currency has, with regard to exchange gains and losses, was not previously mentioned before. These gains and losses can be interpreted differently depending on the currency that generated them. By gathering information about the foreign currency, it is possible to estimate whether unrealized gains and losses will increase or reverse. Estimation of realized gains and losses can be obtained with the disclosure of the major currencies. This disclosure reflects another important economical aspect of exchange gains and losses.

To avoid confusion in the body of the income statement, it is proposed that the disclosure of foreign currency be in footnotes following the statements.

## Conclusion

### Current Status of FASB #8

The Financial Accounting Standards Board is currently reviewing this statement. They are recommending the use of the current rate method. There exists some discrepancy on the treatment of the exchange gain or loss. There is the recommendation that unrealized gains and losses become a nonoperating item or be a direct charge or credit to retained earnings. A direct charge or credit to retained earnings is a departure from the all-inclusive accounting income concept which states that all revenue, expenses, gains, and losses are included in income, except those resulting from capital transactions. Another recommendation is to defer the unrealized gains and losses and then amortize them over the carrying value of the related item. Under this approach, if the currency is continually being devalued over the periods, deferral occurs until the related item is disposed. This method leads to postponing the inevitable.

### Other Closing Remarks

No translation method is suitable in all situations. It is felt that the current rate method is superior because it best reflects economic reality. It shows the financial statements from a local viewpoint, not a parent company's viewpoint. Disclosure of the different aspects of the exchange gains and losses is strongly recommended under any translation method selected for use by the FASB.

The following comprehensive review covers points mentioned in the paper.

## 1979 BALANCE SHEET

| | FOREIGN CURRENCY | U.S. DOLLAR CURRENT RATE | U.S. DOLLAR FASB #8 * |
|---|---|---|---|
| Cash | FC 700 | $ 560 | $ 560 |
| Accts. Rec. | 1100 | 880 | 880 |
| Inventory (FIFO) | 1200 | 960 | 1080 |
| Plant & Equipment | 6000 | 4800 | 6750 |
| Land | 2000 | 1600 | 2400 |
| Total Assets | FC 11,000 | $ 8,800 | $ 11,670 |
| Accts. Pay. | FC 1100 | $ 880 | $ 880 |
| Notes Pay. | 1200 | 960 | 960 |
| Bonds Pay. | 2100 | 1680 | 1680 |
| Mortgage Pay. | 1700 | 1360 | 1360 |
| Common Stock | 3500 | 2800 | 4200 |
| Add. Paid-In Cap. | 500 | 400 | 600 |
| Retained Earnings | 900 | 720 | 1990 |
| Total Liab. & Owner's Equity | FC 11,000 | $ 8,800 | $ 11,670 |

## 1978 BALANCE SHEET

| | FOREIGN CURRENCY | U.S. DOLLAR CURRENT RATE | U.S. DOLLAR FASB #8 * |
|---|---|---|---|
| Cash | FC 600 | $ 600 | $ 600 |
| Accts. Rec. | 1000 | 1000 | 1000 |
| Inventory (FIFO) | 800 | 800 | 880 |
| Plant & Equipment | 5000 | 5000 | 6000 |
| Land | 2000 | 2000 | 2400 |
| Total Assets | FC 9,400 | $ 9,400 | $ 10,880 |
| Accts. Pay. | FC 800 | $ 800 | $ 800 |
| Notes Pay. | 1000 | 1000 | 1000 |
| Bonds Pay. | 2000 | 2000 | 2000 |
| Mortgage Pay. | 1000 | 1000 | 1000 |
| Common Stock | 3500 | 3500 | 4200 |
| Add. Paid-In Cap. | 500 | 500 | 600 |
| Retained Earnings | 600 | 600 | 1280 |
| Total Liab. & Owner's Equity | FC 9,400 | $ 9,400 | $ 10,880 |

Exchange Rates

| | | | |
|---|---|---|---|
| January 1, 1978 | FC 1 : 1.2 | Average Rate 1978 | FC 1 : 1.1 |
| January 1, 1979 | FC 1 : 1.0 | Average Rate 1979 | FC 1 : .9 |
| January 1, 1980 | FC 1 : .8 | | |

*Refer to Exhibits 1,2, and 3 for assumptions used under this method of translation.

## 1979 INCOME STATEMENT

| | FOREIGN CURRENCY | U.S. DOLLAR CURRENT RATE | U.S. DOLLAR FASB # 8 |
|---|---|---|---|
| Sales | FC 2000 | $ 1600 | $ 1800 |
| Interest Income | 600 | 480 | 540 |
| Total Revenue | FC 2600 | $ 2080 | $ 2340 |
| COGS (FIFO) | FC 800 | $ 640 | $ 880 |
| Depreciation | 500 | 400 | 600 |
| Selling & Administration | 300 | 240 | 270 |
| Other Expenses | 400 | 320 | 360 |
| Profit Before Taxes | FC 600 | $ 480 | $ 230 |
| Income Tax | 300 | 240 | 270 |
| Net Income (Loss) | FC 300 | $ 240 | $ (40) |

## FOOTNOTE DISCLOSURE

### FASB #8

| CURRENCY | REALIZED | UNREALIZED | TRANSLATION |
|---|---|---|---|
| Spanish Peso | $ 40 | $ 80 | $ 320 |
| French Franc | 70 | 150 | 430 |
| Total | $ 110 | $ 230 | $ 750 |

### CURRENT RATE

| CURRENCY | REALIZED | UNREALIZED |
|---|---|---|
| Spanish Peso | $ 120 | $ (150) |
| French Franc | (20) | (230) |
| Total | 100 | $ (380) |

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