Statement of Financial Accounting Standards No. 1

Note: This Statement has been completely superseded

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FAS1 Summary

Disclosure of Foreign Currency Translation Information

December 1973

Financial Accounting Standards Board
of the Financial Accounting Foundation
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FAS 1: Disclosure of Foreign Currency Translation Information

INTRODUCTION

1. The Financial Accounting Standards Board (FASB) currently has the subject of accounting for foreign currency translation on its technical agenda. As part of that project, the FASB will examine the alternative methods of accounting for foreign currency translation. At the completion of that project, the FASB expects to issue a comprehensive Statement specifying the financial accounting and reporting standards to be applied. The disclosures required by this Statement should not be interpreted to imply that any accounting method is more or less acceptable than any other method.

2. Under existing pronouncements of the Accounting Principles Board (APB) and its predecessor, several significantly different alternatives are acceptable in accounting for foreign currency translation (see Appendix A). These pronouncements, however, are lacking in specific disclosure requirements. A recent survey [1] of foreign currency translation practices indicates that various accounting methods are used. The survey also indicates that a significant proportion of the companies surveyed presented incomplete disclosures of translation methods and the disposition of translation adjustments. Research conducted by the FASB staff supports those findings of the survey. (See paragraph 18.)

3. Because of (a) continuing realignments of exchange rates, (b) the number of accounting alternatives available, (c) the diversity of practice, (d) the lack of specific disclosure requirements in existing accounting pronouncements, and (e) the limited amount of information concerning translation practices presently being disclosed by some companies with important foreign operations, the FASB has concluded that more specific disclosure of current practices in foreign currency translation is now needed.

4. The disclosures required by this Statement are designed to provide information concerning a company's translation practices to facilitate assessment of possible implications with respect to its financial position and results of operations. This Statement does not supersede, alter, or amend any APB Opinion or Accounting Research Bulletin (ARB).

EXPLANATION OF TERMS

5. The following are explanations of certain terms used in this Statement:

a. *Exchange rate* is the ratio between a unit of one currency and the amount of another currency for which that unit can be exchanged at a particular time. A given currency may, in fact, have several categories of exchange rates, such as the financial rate or the commercial rate. Where such categories exist, this Statement does not attempt to specify a particular category as being more appropriate than another.
b. *Current rate* is the exchange rate in effect at the balance sheet date.[2]
c. *Historical rate* is the exchange rate that was in effect when a specific transaction or event occurred.
d *Exchange adjustment* is the effect of an exchange rate change on the carrying amount of assets and liabilities denominated in terms of foreign currency. This term includes adjustments arising from (1) expression, in terms of one currency, of financial statements maintained in another currency, (2) expression, in terms of its own currency, of an entity's unsettled receivables and payables denominated in terms of another currency, (3) settlement of receivables and payables denominated in terms of another currency at an exchange rate different from that at which the receivable or payable was recorded, and (4) for purposes of this Statement, gains or losses on forward exchange contracts.

STANDARDS OF DISCLOSURE

6. The FASB has concluded that certain disclosures shall be made in financial statements that include amounts denominated in a foreign currency which have been translated into the currency of the reporting entity. The amounts may result from transactions, the consolidation of subsidiaries, and the equity method of accounting for investees. The following information [3] shall be disclosed (see Appendix B for examples):

a. A statement of translation policies including identification of: (1) the balance sheet accounts that are translated at the current rate and those translated at the historical rate, (2) the rates used to translate income statement accounts (e.g., historical rates for specified accounts and a weighted average rate for all other accounts), (3) the time of recognition of gain or loss on forward exchange contracts, and (4) the method of accounting for exchange adjustments (and if any portion of the exchange adjustment is deferred, the method of disposition of the deferred amount in future years).
b. The aggregate amount of exchange adjustments originating in the period, the amount thereof included in the determination of income and the amount thereof deferred.
c. The aggregate amount of exchange adjustments included in the determination of income for

the period, regardless of when the adjustments originated.

d. The aggregate amount of deferred exchange adjustments, regardless of when the adjustments originated, included in the balance sheet (e.g., such as in a deferral or in a "reserve" account) and how this amount is classified.

e. The amount by which total long-term receivables and total long-term payables translated at historical rates would each increase or decrease at the balance sheet date if translated at current rates.

f. The amount of gain or loss which has not been recognized on unperformed forward exchange contracts at the balance sheet date.

EFFECTIVE DATE

7. The disclosures required by this Statement shall be made in financial statements reporting results of operations for fiscal periods ending after November 30, 1973 and in financial statements reporting financial position dated after November 30, 1973.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board.

Marshall S. Armstrong, *Chairman*
Donald J. Kirk
Arthur L. Litke
Robert E. Mays
John W. Queenan
Walter Schuetze
Robert T. Sprouse

Appendix A: BACKGROUND INFORMATION

Summary of Pronouncements [4] and Practices

8. Chapter 12 of ARB 43 as modified by paragraph 18 of APB Opinion No. 6, is the authoritative pronouncement with respect to accounting for foreign currency translation. Chapter 12 calls for translation by the "current-noncurrent method," that is, translation of current assets and liabilities at the current rate and translation of noncurrent assets and liabilities at historical

rates. Under Chapter 12 all exchange losses are charged to income, realized gains are credited to income, and unrealized gains are preferably deferred, except that such gains may be credited to income to the extent that they offset previously recognized losses.

9. Chapter 12 of ARB 43 provides exceptions to these general rules. Under special circumstances (see paragraph 16 of Chapter 12) inventory may be stated at the historical rate. Long-term debt incurred or capital stock issued in connection with the acquisition of long-term assets shortly before a substantial and presumably permanent change in the exchange rate may be restated at the new rate. If the debt or stock is restated, an equivalent adjustment is to be made to the long-term assets. (See paragraphs 12 and 18 of Chapter 12.)

10. A research report [5] published in 1960 describes the current-noncurrent distinction as one which "seems to reflect the use of an established balance sheet classification for a purpose to which it is not relevant." In addition, the report describes the monetary-nonmonetary distinction. Based on this distinction, inventory, being nonmonetary, should be translated at historical rates of exchange, and noncurrent receivables and payables, being monetary items, should be translated at current rates.

11. The development in practice of translating all payables and receivables at current rates was given official recognition with the issuance in 1965 of APB Opinion No. 6. Paragraph 18 of Opinion No. 6 states, without specifying the circumstances, that "translation of long-term receivables and long-term liabilities at current exchange rates is appropriate in many circumstances." This modification of Chapter 12 of ARB 43, in effect, permits use of the monetary-nonmonetary method of translation.

12. Because of extensive currency realignments in 1971, the APB considered the problem of foreign currency translation and issued an exposure draft proposing that companies using the monetary-nonmonetary method defer exchange adjustments to the extent they did not exceed those attributable to long-term debt. Amounts deferred were to be accounted for in a manner similar to debt discount.[6] This draft, in effect, gave rise to another method of accounting for exchange adjustments. An Accounting Research Study [7] was in process at the time and the U.S. dollar was devalued during the exposure period. The APB deferred action on the exposure draft and announced that companies should disclose how they accounted for exchange adjustments. The APB also noted that some companies had adopted the recommendations of the exposure draft, thus achieving somewhat the same effect as translating long-term receivables and payables at historical rates.[8]

13. Paragraph 13 of APB Opinion No. 22 specifies that disclosure should be made of accounting policies with respect to translation of foreign currencies. This disclosure should "describe the accounting principles followed . . . and the methods of applying those principles that materially affect the determination of financial position, changes in financial position, or results of operations." (Paragraph 12 of APB Opinion No. 22.)

14. While there is no specific reference to foreign currency translation in APB Opinion No. 19, the APB did conclude that "the statement summarizing changes in financial position should be based on a broad concept embracing all changes in financial position" and that the statement of changes in financial position "should disclose all important aspects of its financing and investing activities regardless of whether cash or other elements of working capital are directly affected." (Paragraph 8 of APB Opinion No. 19.)

15. Chapter 12 of ARB 43 states, ". . . it is important that especial care be taken to make full disclosure in the financial statements of United States companies of the extent to which they include significant foreign items" (paragraph 6) and ". . . adequate disclosure of foreign operations should be made" (paragraph 8).

16. Chapter 12 of ARB 43 was amended as of 1967 by APB Opinion No. 9. Paragraph 21 of APB Opinion No. 9 states the conditions under which an exchange adjustment should be reported as an extraordinary item, and paragraph 22 states when it should not be reported as an extraordinary item. These paragraphs have been superseded by APB Opinion No. 30 for events and transactions occurring after September 30, 1973. Paragraph 23 of Opinion No. 30 states that "certain gains or losses should not be reported as extraordinary items" and names "gains or losses from exchange or translation of foreign currencies, including those relating to major devaluations and revaluations" as not qualifying as extraordinary items. Paragraph 27 of Opinion No. 30 states that "differences in classification . . . of the current and any prior periods presented should be disclosed in notes to the financial statements."

17. A company that changes its methods of accounting for foreign currency translation is required to make certain disclosures by APB Opinion No. 20. Those disclosures are not discussed here.

Summary of Research Findings

18. The FASB research staff reviewed recent annual financial statements of seventy-seven companies engaged in foreign operations with regard to the disclosure of translation practices. The population used in this study consisted of the companies appearing on the following lists:

a. The Financial Executives Institute, *Survey of U.S. Company Foreign Translation Practices* (July 31, 1973).
b. The major multinational companies as reported by *Business Week*, August 18, 1973.
c. The U.S. companies that derived the most sales from their overseas operations in 1970 as reported by *Dun's*, April, 1973.

A variety of methods of determining and accounting for foreign currency exchange adjustments was found. Further, it was found that a significant proportion of the companies made incomplete disclosures of translation methods and the disposition of exchange adjustments.

Summary of Consideration of Comments on Exposure Draft

19. In response to the request for comments on the Exposure Draft dated October 19, 1973, seventy-four letters were received and considered by the FASB in its deliberations on this Statement. Certain of the comments and the FASB's consideration of them are summarized in paragraphs 20-25.

20. Suggestions were made that the definition in paragraph 5(d) explicitly include realized exchange gains and losses as well as gains and losses on forward exchange contracts. The FASB adopted these suggestions and, for emphasis, the term "translation adjustment" used in the Exposure Draft has been changed to "exchange adjustment" in this Statement.

21. The importance of the use of forward exchange contracts in the financial management of foreign operations was emphasized. In recognition of this and because of the apparent variety of methods of recognizing gain or loss on forward exchange contracts,[9] the FASB added specific requirements with respect thereto in paragraphs 6(a)(3) and 6(f).

22. A need was indicated for disclosure of tax effects of exchange adjustments and for a statement of policy with regard to interperiod tax allocation on exchange adjustments. Because of the complexity in determining the taxability of exchange adjustments and the interrelationship of such with the provisions of APB Opinions No. 23 and No. 24, the FASB concluded that it would prefer to consider the matter further before requiring such disclosures. This Statement requires before tax amounts as opposed to after tax amounts. Where appropriate, the FASB encourages the separate disclosure of tax effects.

23. The Exposure Draft contained the following proposed disclosure requirement which is not included in this Statement:

> *The amounts of changes in long-term receivables or long-term payables reflected in the statement of changes in financial position that are attributable to translation and the effect of translation on the net change in working capital.*

The belief was expressed that APB Opinion No. 19 was not intended to cover such changes in financial position or that compliance was impracticable because of the number of transactions and balances affected by numerous exchange rate changes. Research by the FASB disclosed that some companies are furnishing in the statement of changes in financial position the type of information contemplated in the proposed requirement. However, because it was indicated that many companies would have difficulty in furnishing the desired information, the FASB decided not to require such information at the present time. This subject will be considered further as part of the comprehensive project on accounting for foreign currency translation. The FASB encourages those companies which have been furnishing the information to continue to do so and others to do so where practicable.

24. The Exposure Draft contained the following proposed disclosure requirement:

> *If historical rates have been used in translating long-term receivables or long-term payables, the amount each of these classifications would increase or decrease in the balance sheet if translated at the current rate.*

a. The assertion was made that, by proposing this disclosure, the FASB appeared to be indicating a preference for translation at the current rate. Translation of long-term receivables and payables at historical rates is an acceptable accounting method, and in proposing this requirement, the FASB did not, in fact, intend to imply any preference for translation at current rates.
b. Objections were expressed because companies using an acceptable method of accounting were being asked to disclose the effect of using a different method. The use of historical rates to translate long-term receivables and payables in effect defers the recording of an exchange adjustment until the asset or liability is reclassified as current. Companies using the current rate to translate long-term receivables and payables record an exchange adjustment related thereto when an exchange rate changes, but may defer exchange adjustments. The FASB believes that information as to all deferrals of exchange adjustments should be furnished. Therefore the requirement is retained in slightly different form as paragraph 6(e).

25. It was suggested that the required disclosures be considered only after public hearings as a portion of the FASB's previously announced comprehensive study on accounting for foreign currency translation or that the effective date of applicability be deferred. After considering these suggestions, however, the FASB judged that, on the basis of existing data, it could make an informed decision on this Statement without a public hearing. Also, on consideration of the circumstances mentioned in paragraph 3 of this Statement, the FASB judged that the effective date specified in paragraph 7 would be advisable.

Appendix B: EXAMPLES OF DISCLOSURE

26. The disclosures specified by paragraph 6 of this Statement may be accomplished in various ways; for example, by a clearly captioned amount separately identified in the body of the financial statements, by a description in the summary of significant accounting policies, by explanation in the notes to the financial statements, or by combinations thereof. The following are to be considered only as examples of the disclosures which might be made to comply with the disclosure requirements specified by this Statement.

27. Paragraph 6(a) calls for a statement of translation policies including identification of: (1) the balance sheet accounts that are translated at the current rate and those translated at the historical rate, (2) the rates used to translate income statement accounts, (3) the time of

recognition of gain or loss on forward exchange contracts, and (4) the method of accounting for exchange adjustments. For example, a company which uses the current-noncurrent method of translation might state the following concerning its policy for translating assets and liabilities, for time of recognition of gain or loss on forward exchange contracts, and for disposition of the exchange adjustment:

> Current assets and current liabilities are translated at the rate of exchange in effect at the close of the period. Long-term assets are translated at the rates in effect at the dates these assets were acquired, and long-term liabilities are translated at the rates in effect at the dates these obligations were incurred. Exchange adjustments, including gain or loss on settled forward exchange contracts, are charged or credited to income.

Or, the following might replace the last sentence:

> Net unrealized losses from foreign currency translation are charged to income currently. Net unrealized gains from foreign currency translation are credited to Deferred Foreign Currency Exchange Gains, except that these gains are credited to income currently to the extent of losses previously charged to income. Gain or loss on forward exchange contracts is recognized in income upon settlement.

A company which uses the monetary-nonmonetary method of translation might state:

> Inventory, property, plant, equipment, deferred charges, . . . are translated at the rates of exchange in effect when acquired. All other assets and liabilities are translated at the rate of exchange in effect at the close of the period. Exchange adjustments are deferred to the extent that they do not exceed those that are attributable to long-term debt and are amortized by the interest method over the remaining term of the debt. Otherwise, they are charged or credited to income currently. Gain or loss on forward exchange contracts is recognized in income upon settlement.

As to rates used to translate income statement accounts, the accounting policy might be stated as follows:

> Revenue and expense accounts for each month are translated at the average rate of exchange in effect during the month, except for depreciation and amortization which are translated at the rates of exchange which were in effect when the respective assets were acquired.

Or, as follows:

> Revenue and expense accounts are translated at a weighted average of exchange

> rates which were in effect during the year, except for depreciation . . . etc.

28. Paragraph 6(b) calls for disclosure of the aggregate amount of exchange adjustments originating in the period, the amount thereof included in the determination of income and the amount thereof deferred. A company which includes all exchange adjustments in the determination of income for the year and so states in a description of its accounting policies might identify the amount by reporting it separately in its income statement as follows:

Foreign Currency Exchange Losses	$XX,XXX

A company that follows the recommendations of paragraph 11 of Chapter 12 of ARB 43 might state in a note:

> In 1973, the Company charged unrealized foreign currency exchange losses of $12,345 for the year to income. In 1974, the Company credited $12,345 of its $54,321 unrealized foreign currency exchange gain for the year to income and credited the remaining $41,976 to Deferred Foreign Currency Exchange Gains.

29. Paragraph 6(c) calls for disclosure of the aggregate amount of exchange adjustments included in the determination of income for the period, regardless of when the adjustments originated. This disclosure will generally be fulfilled by the disclosure called for under paragraph 6(b) unless amortization of exchange adjustments originating in prior periods has been included in income for the current year. For example, a company that defers the exchange adjustment (wholly or partially) and amortizes it would disclose the amount amortized in the current year from past years plus or minus any portion of the current year's exchange adjustment included in income.
A company might state the following:

> Foreign currency exchange adjustments of $100,000 originating during the year and amortization of $10,000 of previously deferred exchange adjustments have both been charged to income.

30. Paragraph 6(d) calls for disclosure of the aggregate amount of deferred exchange adjustments included in the balance sheet and how this amount is classified. The disclosures called for here may be accomplished by a separate caption in the balance sheet or by disclosure in a note.

For example, a company might have a separate caption in its balance sheet as follows:

Deferred Foreign Currency Exchange Gains	$XXX,XXX

Another company might state in a note:

> Deferred Charges at December 31, 1973, includes foreign currency exchange adjustments amounting to $XXX,XXX.

31. Paragraph 6(e) calls for disclosure of the amount by which long-term receivables and payables translated at historical rates would each increase or decrease at the balance sheet date if translated at current rates.

A company might state the following:

> The Company translates foreign currency long-term receivables at the rates of exchange in effect when the sales were made and translates foreign currency long-term debt at the rates of exchange in effect when these obligations were incurred. Translated at the rates of exchange in effect on December 31, 1973, long-term receivables would increase by $3,210,000 and long-term debt would increase by $5,432,000.

As an alternative, that same company (assuming the company disclosed in its balance sheet at December 31, 1973, total U.S. dollar and foreign currency long-term receivables in the amount of $65,432,000 and total U.S. dollar and foreign currency long-term debt in the amount of $76,543,000) might substitute for the last sentence above the following:

> . . . . Translated at the rates of exchange in effect on December 31, 1973, total long-term receivables would be $68,642,000 and total long-term debt would be $81,975,000.

32. Paragraph 6(f) calls for disclosure of the amount of gain or loss which has not been recognized on unperformed forward exchange contracts at the balance sheet date. A company which accrues losses on such contracts might state the following:

> The Company accrues losses on all unperformed forward exchange contracts and records gains at maturity. At December 31, 1973, unrecorded gains based on exchange rates then in effect amounted to $XX,XXX.

Footnotes

FAS1, Footnote 1--Financial Executives Institute, *Survey of U.S. Company Foreign Translation Practices,* July 31, 1973.

FAS1, Footnote 2--See paragraph 14 of Chapter 12 of ARB 43 regarding forward exchange contracts.

FAS1, Footnote 3--This Statement does not require companies to change accounting methods. On occasion, the accounting methods employed may be such that it is not reasonably possible to provide all amounts required in paragraphs 6(b), (c) or (d). For example, an importer may have recorded as a part of the cost of merchandise an amount defined in the Statement as an exchange adjustment, and, therefore, may be unable to determine all or part of an amount required. Where this is so, an estimate shall be furnished if feasible. If an estimate cannot be furnished, an explanation shall be provided.

FAS1, Appendix A, Footnote 4--The purpose of paragraphs 8-17 of this Appendix is to provide references to relevant pronouncements. These paragraphs should not be considered as interpretations by the FASB of any pronouncement cited.

FAS1, Appendix A, Footnote 5--National Association of Accountants, *Management Accounting Problems in Foreign Operations,* Research Report No. 36 (New York: NAA, 1960), p. 17.

FAS1, Appendix A, Footnote 6--Proposed APB Opinion, *Translating Foreign Operations,* Exposure Draft, December 20, 1971.

FAS1, Appendix A, Footnote 7--Leonard Lorensen, *Reporting Foreign Operations of U.S. Companies in U.S. Dollars,* Accounting Research Study No. 12 (New York: AICPA, 1972).

FAS1, Appendix A, Footnote 8--*Accounting Research Association Newsletter,* January 28, 1972, p. 1.

FAS1, Appendix A, Footnote 9--Financial Executives Institute, *Survey of U.S. Company Foreign Translation Practices,* July 31, 1973.