Financial Statement Analysis and the Harmonization of Foreign Currency Translation

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Abstract

The harmonization of foreign currency translation accounting has lead to global acceptance of the temporal and current or closing rate methods. These methods have the potential to alter financial statement analysis from that done on untranslated information. This paper demonstrates the differences in financial results from these methods and calls for revisiting the issue of foreign currency translation to develop a single method for comparability in financial statement analysis.

Introduction

Financial statement analysis of multinational corporations (MNC's) is becoming increasingly complex, due to the further globalization of MNC's and the development of a world economy. MNC's are expanding their markets overseas to become globally competitive. No longer is the international dimension of their businesses only a mere portion of their total activity.

The changing economic organization of Western Europe and the creation of a new market in Eastern Europe are two forces augmenting the world economy. Coupled with existing competition from the Far East, MNC's are entering world markets at an accelerated pace. This is both an opportunity and a necessity for MNC's.

This increased multinational activity raises issues about the reliability of information describing performance of foreign operations (Bodenberg, 1982), as this segment of information now represents a significant portion of total firm activity. Does the foreign information in its translated form distort company performance or is it reliable? Should it be translated in the first place? What is the impact from foreign information on financial statement analysis?

These questions are not new. They are simply becoming more important issues. Hawkins (1969) questioned the ability to use U.S. information to control U.S. foreign operations. Mauriel (1969) and Robbins and Stobaugh (1973) specifically identified problems using standardized reports to control foreign operations. Empirical work testing usage of information to evaluate foreign operations began with Morsicato and Radebaugh

(1977) and Abdallah (1982). The former found in U.S. MNC's different preferences for information at home office for performance evaluation when the information was translated versus untranslated.

There is, therefore, a serious potential for financial statement analysis to be influenced by translated financial statements as compared to the same analysis done before translation, as key ratios can change and some analysts prefer untranslated data while others prefer translated information. In addition, the choice of translation method also can affect financial statement analysis. Through harmonization efforts, the available translation methods are becoming consistent worldwide. In particular, Canadian and British translation methods are materially the same as those of the U.S. While from the standpoint of harmonization this is laudable, the confusion found in U.S. financial statement analysis may become a global problem.

The following discussion relates to the problem of financial statement analysis of U.S. MNC's. This allows the creation of an example which demonstrates multinational financial statement analysis. Virtually the same example, however, can be used to illustrate translation in other nations such as the U.K. through Statement of Standard Accounting Practice (SSAP) No. 20 (1983), Canada through the Canadian Institute of Chartered Accountants (CICA) *Handbook*, Section 1650 (1983), or any nation adhering to the International Accounting Standards Committee recommendation *International Accounting Standards No. 21* (1983).

The Essentials of Foreign Currency Translation in the U.S.

Statement on Financial Accounting No. 52, "Foreign Currency Translation," SFAS 52 (1981) identifies two methods of translating the financial statements of foreign operations. These are the temporal method and the current rate method. The latter is called the closing rate method outside the U.S. The methods are not alternatives, and the Statement explains the circumstances when the two methods are to be used.

Under the temporal method, assets are translated at the current exchange rate at the balance sheet date, if they are monetary items. Otherwise, they are translated at the historic exchange rate at the time of their acquisition. Liabilities, since they are monetary items, are also translated at the exchange rate at the balance sheet date. Stockholder equity is brought forward at the historic rate at the date of purchase of the company or issue of the stock plus or minus any changes in equity since that time. These changes include dividends and earnings. Dividends are translated at the exchange rate at the time of the dividends, and earnings are related to historical cost assets. Expenses, such as depreciation, are translated at the exchange rate of the asset being removed from the balance sheet. Current and evenly incurred revenues and expenses for the year are translated at the average rate for the year. Any amount needed to balance assets and equities is the translation exchange rate gain or loss and is included in income.

The temporal method attempts to retain the historical cost aspect of foreign statements by translating the activities of the year as if they took place in the currency of the reporting parent. The method is used when the foreign entity is closely tied to the domestic reporting parent. The functional currency of the entity is said to be the currency of the parent, if evidenced by substantial profit repatriation or the fact that the foreign entity conducts much of its business in the currency of the reporting parent. For U.S. MNC's, the functional currency is usually the U.S. dollar. Moreover, the temporal method is used, regardless of the functional currency, if the three year inflation rate is greater than 100% in the foreign country concerned. This is because the inflation is usually accompanied by a dramatic depreciation of the foreign currency. Should the otherwise appropriate current rate method be used, asset shrinkage would be unwieldy.

Under the current rate method, all assets and liabilities are translated at the exchange rate at the balance sheet date, and stockholder equity accounts are brought forward at the previous historical balances plus or minus changes such as dividends and earnings. Dividends are translated at the rate in effect at the time of the dividend, and revenues and expenses are translated at the

average rate for the year. The amount needed to balance assets and equities is the cumulative translation adjustment and becomes part of stockholder equity and not part of income.

In the year of transition to the current rate method (1981-1983), financial statements were first translated using the temporal method, recognizing a gain or loss, and then further translated using the current rate method. The difference in the two translations provided the opening balance of the cumulative translation adjustment. First year translations of companies formed or purchased subsequent to the issue of SFAS 52 are identical under both methods, as the parent company's cost on the date of purchase is used to value the assets.

The current rate method is used when the foreign entity is autonomous from the reporting parent, as is evidenced by the foreign entity conducting its business mostly in the foreign currency. Additionally, if there is reinvestment of profits in the foreign country and limited repatriation of profits to the domestic parent, the current rate method will be used. Under these conditions, the functional currency is said to be the foreign currency. Under these circumstances, the likelihood of the parent company realizing gains and losses from translation is much less than that of a closely tied branch, and, accordingly, no gain or loss is recognized in the income statement from exchange rate movements.

Illustration of SFAS 52 Cash Flow and Financial Statement Analysis

The following illustration was created from part of a case developed by Choi (1987). The amounts assigned to certain accounts have been altered for demonstration purposes as have some of the assumptions. The illustration begins with a foreign operation (EXHIBIT 1) with comparative balance sheets, income statement, and cash flow statement using U.S. Generally Accepted Accounting Principles, but expressed in foreign currency, the P.

The above foreign affiliate must be translated into the U.S. dollars before consolidation or before segment reporting under *Statement of Financial Accounting Standards No. 14, "Financial Reporting for Segments of a Business Enterprise,"* SFAS 14 (1976). As mentioned, there are two techniques for translation under SFAS 52, the temporal method and the current rate method. Some assumptions must be made, however, before translation can be illustrated.

Assumptions

1. The foreign operation was acquired in 1985 when the exchange rate was $P1 = \$0.40$. Only property, plant and equipment remain on the

Exhibit 1
Foreign Operation
Comparative Balance Sheets, Income and Cash Flow Statements
000's omitted

Balance Sheets	December 31	
	1989	1990
Assets		
Cash	P 20,000	P 22,000
Accounts Receivable	34,000	90,000
Inventory	40,000	30,000
Property, Plant & Equipment	100,000	100,000
Accumulated Depreciation	(20,000)	(30,000)
Total Assets	P 174,000	P 212,000
Liabilities & Equity		
Accounts Payable	P 30,000	P 50,000
Long Term Debt	44,000	52,000
Common Stock	60,000	60,000
Retained Earnings	40,000	50,000
Total Liabilities & Equity	P 174,000	P 212,000
Income Statement for year ending December 31, 1990		
Sales		P 230,000
Cost of Sales:		
Beginning Inventory	P 40,000	
Purchases	100,000	
Available for Sale	140,000	
Ending Inventory	30,000	110,000
Gross Margin		P 120,000
Expenses:		
Depreciation	P 10,000	
Other	94,000	
Taxes	6,000	110,000
Net Income		P 10,000
Retained Earnings 12/31/89		40,000
Retained Earnings 12/31/90		P 50,000
Cash Flow Statement for year ending December 31, 1990		
Cash Provided from Operations		P 10,000
Net Income		10,000
Add Depreciation		20,000
Increase in Accounts Receivable		(56,000)
Decrease in Inventory		10,000
Increase in Accounts Payable		20,000
		P (6,000)
Cash from Financing: Issue of Long Term Debt		8,000
Increase in Cash		P 2,000

The example shows a rapidly depreciating foreign currency. This is deliberate to demonstrate the effects of currency movements on financial statements. Though the currency has lost much of its value during 1990, the three year inflation rate may be below 100%. Therefore, due to the amount of autonomy of the foreign operation, both the current rate and temporal methods can be available under SFAS 52.

The financial statements in Exhibit 1 are presented in Exhibit 2 after translation using the temporal method and the indirect method of presentation for cash flow.

The translation gain in the income statement can be calculated as follows:

Net Monetary Liabilities	
12/31/89	
P 20,000 @ .020	\$ (400)
Increase in Net Monetary Assets	
During 1990	
P 30,000 @ .014	420
Expected Net Monetary Assets	
12/31/90	\$ 20
Translated Net Monetary Assets	
12/31/90	
P 10,000 @ .006	60
Translation Gain	\$ 40

The gain is due to being in a net monetary liability position for most of the year with a depreciating foreign currency.

SFAS 52 does not provide guidance in preparing the cash flow statement. Guidance is provided, however, in *Statement of Financial Accounting Standards No. 95 "Statement of Cash Flows,"* SFAS 95 (1987). The above presentation is consistent with SFAS 95 recommendations and illustrations. The major advantage of this format is its agreement with the untranslated format, due to exchange rate effects being removed. As an example, both show an increase in accounts payable as a source of cash. Thus, both show an increase in cash without regard to translation.

Unfortunately, the above format does not allow easy

- balance sheet from that date.
- Inventory is recorded using FIFO, and existing inventories at year end were acquired in the last quarter of each year.
- Purchases, sales and expenses were made evenly during the year.
- Property, Plant and Equipment are depreciated using the straight line method over 10 years.
- Other relevant exchange rates against the U.S. dollar are:

December 31, 1989	P1 = \$.020
December 31, 1990	P1 = \$.006
Average for 1990	P1 = \$.014
Fourth Quarter Average, 1989	P1 = \$.024
Fourth Quarter Average, 1990	P1 = \$.010

Exhibit 2
Foreign Operation: Translated-Temporal Method
Comparative Balance Sheets, Income and Cash Flow Statements
000's omitted

Balance Sheets	December 31	
	1989	1990
Assets		
Cash	\$ 400	\$ 132
Accounts Receivable	680	540
Inventory	960	720
Property, Plant & Equipment	4,000	4,000
Accumulated Depreciation	(800)	(1,200)
Total Assets	<u>\$ 5,240</u>	<u>\$ 4,192</u>
Liabilities & Equity		
Accounts Payable	\$ 600	\$ 300
Long Term Debt	880	312
Common Stock	2,400	2,400
Retained Earnings	1,360	1,180
Total Liabilities & Equity	<u>\$ 5,240</u>	<u>\$ 4,192</u>
Income Statement for year ending December 31, 1990		
Sales		\$ 3,220
Cost of Sales:		
Beginning Inventory	\$ 960	
Purchases	1,400	
Available for Sale	2,360	
Ending Inventory	720	1,640
Gross Margin		\$ 1,580
Expenses:		
Depreciation	\$ 400	
Other	1,316	
Taxes	84	1,800
Operating Income (Loss)		\$ (220)
Translation Gain		40
Net Income (Loss)		<u>\$ (180)</u>
Retained Earnings 12/31/89		1,360
Retained Earnings 12/31/90		<u>\$ 1,180</u>
Cash Flow Statement for year ending December 31, 1990		
Cash Provided from Operations		
Net Income (Loss)		\$ (180)
Deduct Translation Gain		(40)
Add Depreciation		400
		180
Increase in Accounts Receivable		(784)
Decrease in Inventory		240
Increase in Accounts Payable		280
		<u>\$ (84)</u>
Cash from Financing: Issue of Long Term Debt		112
Increase in Cash Before Translation		\$ 28
Translation Adjustment to Cash		(296)
Decrease in Cash		<u>\$ (268)</u>

reconciliation with the changes in the translated balance sheet amounts. Furthermore, the translation adjustment to cash is not the entire translation adjustment change on the balance sheet. Nevertheless, the above format meets minimum reporting requirements under SFAS 95.

A complete reconciliation of the cash flow statement using the translated comparative balance sheets and income statement amounts with the above format is given in APPENDIX 1 with explanation of the reconciliation. The exchange rate effects on the changes in asset and liability accounts affected are shown. The same foreign operation (EXHIBIT 1) can be translated using

the current rate or closing rate method as shown in EXHIBIT 3. Note that the beginning translated balance of retained earnings is the same as that of the temporal method. This is required for the year of transition under SFAS 52 and done here only to provide a starting point for the opening balance in the cumulative translation adjustment account.

The reconciliation of cash flow using translated balances with and without the exchange rate effect removed is shown in Appendix 2.

The cumulative translation adjustment can be proven as follows:

Net Assets 12/31/89	
P 100,000 @ .020	\$ 2,000
Increase in Net Assets for the Year P 10,000 @ .014	140
Expected Net Assets 12/31/90	\$ 2,140
Translated Net Assets 12/31/90 P 110,000 @ .006	660
Translation Adjustment for 1990	\$(1,480)
Cumulative Translation Adjustment 12/31/89	(1,760)
Cumulative Translation Adjustment 12/31/90	\$(3,240)

Discussion

A cursory look at the three representations of the same financial events shows that there are many differences. A positive cash flow in foreign currency became a negative cash flow in translated dollars, and a positive income in foreign currency is also an income under current

rate translation, but a loss when translated using the temporal method. A summary of some of the key comparisons is presented in EXHIBIT 4.

The temporal method shows a loss because the translation loss is charged to income and because depreciation expense and cost of sales are translated at higher historical exchange rates than the average rate for the year. Return on Investment (net assets) is lower for the current rate method from that of the untranslated, due to the income being translated at a rate lower than the December 31, 1989 rate.

Exhibit 3
Foreign Operation: Translated-Current Rate Method
Comparative Balance Sheets, Income and Cash Flow Statements
000's omitted

Balance Sheets	December 31	
	1989	1990
Assets		
Cash	\$ 400	\$ 132
Accounts Receivable	680	540
Inventory	800	180
Property, Plant & Equipment	2,000	600
Accumulated Depreciation	(400)	(180)
Total Assets	<u>\$ 3,480</u>	<u>\$ 1,272</u>
Liabilities & Equity		
Accounts Payable	\$ 600	\$ 300
Long Term Debt	880	312
Common Stock	2,400	2,400
Cumulative Translation Adjustment	(1,760)	(3,240)
Retained Earnings	<u>1,360</u>	<u>1,500</u>
Total Liabilities & Equity	<u>\$ 3,480</u>	<u>\$ 1,272</u>
Income Statement for year ending December 31, 1990		
Sales		\$ 3,220
Cost of Sales:		
Beginning Inventory	\$ 800	
Purchases	1,400	
Available for Sale	2,200	
Less Translation Adjustment	480	
Ending Inventory	<u>180</u>	<u>1,540</u>
Gross Margin		\$ 1,680
Expenses:		
Depreciation	\$ 140	
Other	1,316	
Taxes	<u>84</u>	<u>1,540</u>
Net Income		\$ 140
Retained Earnings 12/31/89		<u>1,360</u>
Retained Earnings 12/31/90		<u>\$ 1,500</u>
Cash Flow Statement for year ending December 31, 1990		
Cash Provided from Operations		
Net Income		\$ 140
Add Depreciation		<u>140</u>
		280
Increase in Accounts Receivable		(784)
Decrease in Inventory		140
Increase in Accounts Payable		<u>280</u>
		\$ (84)
Cash from Financing: Issue of Long Term Debt		<u>112</u>
Increase in Cash Before Translation		\$ 28
Translation Adjustment to Cash		<u>(296)</u>
Decrease in Cash		<u>\$ (268)</u>

Translated working capitals and current ratios differ, due to the exchange rates applied by the two methods to inventories. This also causes total assets to differ and further affects equity in the debt/equity ratio. Finally, positive untranslated cash flow turns into a negative cash flow when translated under either method, due to the depreciating exchange rate.

The above example was deliberately contrived to illustrate potential differences once translation takes place under either method. By no means can one reasonably expect that all these differences are likely to occur. Yet, some are likely to happen (Brancovic and

Madura, 1990). Furthermore, a completely different set of results will occur if the foreign currency appreciated, if the foreign entity reports a loss, reports a negative cash flow, or if the foreign entity consists of relatively more or less monetary items (Selling and Sorter, 1983). The possibilities for differences in reported results, therefore, are enormous.

Implications for Financial Statement Analysis

As mentioned, if the preceding example were British or Canadian, the major difference would be in the reporting currency and not in accounting procedures. Given the success in harmonization efforts, MNC's from a variety of countries can experience the same kinds of comparisons as in the U.S. example. While this may be consistent for financial reporting purposes, some serious problems arise in financial statement analysis.

There is also the issue of whether or not the statements should be translated in the first place (Schweikart, 1981). There is reason to believe that financial statements are meaningful only if reported in the foreign currency of the country of origin. Furthermore, comparisons are environmentally bounded within that country. Therefore, foreign operations should only be rated against a national norm and competing operations within that nation.

For example, labor expenses in South Korea are significantly lower than Germany. Accordingly, incomes in the two nations cannot be compared, and the need to translate is obviated. Only incomes within Germany or within South Korea are comparable.

Unfortunately, the above argument does not help the needs of MNC home offices which need to report all operations worldwide in the same currency. From their standpoint, comparative returns on investment in home country currency are necessary to establish relative successes in their segments. Hence, translation is mandated, even if it is not the best practice, not only for

Exhibit 4
Foreign Operation Comparative
Financial Analysis for 1990
(all balance sheet ratios are for 1990)

	<u>Untranslated</u>	<u>Current Rate</u>	<u>Temporal</u>
Income	P 10,000	\$ 140	\$ (180)
Income/Sales	.044	.044	(.056)
Return on Investment	.100	.070	(.048)
Working Capital	P 92,000	\$ 552	\$ 1,092
Current Ratio	2.840	2.840	4.640
Quick Ratio	2.240	2.240	2.240
Debt/Equity	1.020	.927	.171
Total Assets	P 224,000	\$ 1,272	\$ 4,192
Cash from Operations	P (6,000)	\$ (84)	\$ (84)
Cash from Financing	P 8,000	\$ 112	\$ 112
Change in Cash	P 2,000	\$ (268)	\$ (268)

consolidation but control purposes as well.

If translation is needed for control and performance evaluation, there is a real issue as to the correct method to do this (Beaver and Wolfson, 1984). Currently, a MNC can have two operations within the same country translated differently because of the relationships each has with the parent. If both had similar results in the foreign currency, they could still have different performances after translation. In addition, of course, operations from a variety of countries are not translated consistently.

The accounting profession has dealt with the issue of the correct translation method on a worldwide basis but has been unable to settle on one method. The resulting alternatives provide the biggest differences in financial presentation of any allowable accounting alternatives, such as inventory and depreciation methods. For a profession concerned with comparability, this is very unusual.

Given the state of foreign currency translation accounting, a great deal of care must be taken in financial statement analysis. Perhaps analysis should be done on untranslated and translated statements using both the temporal and current (closing) rate methods, regardless of the relationship the foreign operation has with the parent. This will at least provide a range of results and provide some insight into performance. In addition, both MNC standards and national performance norms should be used to measure performance. This may be laborious, but it is probably necessary.

Conclusion

There is a preference for using translated information in U.S. MNC's for decision making. This paper has shown that translated information can show a very

different performance level of a foreign operation from that of untranslated information. In addition, the translation method used affects reported performance. Thus, financial statement analysis can be confusing and unclear.

Given the success in harmonizing efforts by the International Accounting Standards Committee and its members, other countries adopting similar translation procedures are facing the same confusion, especially if they also have a preference for translated information.

An accounting profession whose purpose is to provide meaningful information for users of financial reports must reopen the translation issue. At a minimum, a single method should be adopted for comparability both within and across organizations, and untranslated information should accompany translated financial reports.

Suggestions for Future Research

An assessment of the effect of the two translations on financial analysis should be done using a behavioral science framework. Scenarios of financial performance prior to translation and after translation using the temporal and current rate methods will allow an understanding of analysts' differences in perceptions of foreign operations. Should the translations produce significantly different performance evaluations, then further assessment of which method is more appropriate should be undertaken. In this way, consensus on performance evaluation eventually can be achieved through narrowing the differences in the two methods.

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Appendix 1
Cash Flow Statement
with Exchange Rate Effect: Temporal Method

I. The following shows the calculation of the exchange rate gain, by balance sheet account, in the illustration (Temporal Method):

1 Translated Balances @.020 12/31/89	2* Translated Changes @.014	1+2=3 Expected Balance 12/31/90	4 Translated Balances @.006 12/31/90	3-4 Gain (Loss)
Cash \$ 400	\$ 28	\$ 428	\$ 132	\$ (296)
Rec. 680	784	1,464	540	(924)
A.Pay. (600)	(280)	(880)	(300)	580
L.T.D. (880)	(112)	(992)	(312)	680
Net \$(400)	\$ 420	\$ 20	\$ 60	\$ 40

*The translated changes are the differences between the 12/31/89 and 12/31/90 amounts in the foreign currency multiplied by the average rate for the year. For example,

Cash	12/31/89	P 20,000	
	12/31/90	P 22,000	
Increase		P 2,000	@ .014 = \$28

II. Understanding the exchange gain or loss on each balance sheet account allows preparation of a cash flow statement without the exchange rate gain or loss removed and with the exchange rate effect removed (SFAS 95 treatment per the illustration) with reconciliation.

Foreign Operation
Translated: Temporal Method
Cash Flow Statement

	I Exchange Rate Effect Unremoved	II Exchange Rate Effect	III FAS 95 ER Removed (illustration)
Income	\$ (180)	-	\$ (180)
Add Depreciation	400	-	400
Ded Translation Gain	(40)	-	(40)
	\$ 180		\$ 180
Receivables (dec)	140	\$ (924) (inc)	(784)
Inventory (dec)	240	- (dec)	240
Acc. Payable (dec)	(300)	580 (inc)	280
From Operations	\$ 260	\$ (344)	\$ (84)
Long Term Debt (dec)	(568)	680 (inc)	112
	\$ (308)	\$ 336	\$ 28
Translation Gain	40	(40)	-
Cash Change	\$ (268)	\$ (296)	\$ 28
			(296)
			\$ (268)

Column I is prepared using the translated balance sheets and income statements of Exhibit II. By removing the exchange gain/loss calculated above (column II), balance sheet account changes are those resulting from the expected 12/31/90 balances. Accordingly, a reconciliation to the reported cash change is made at the bottom of column III. Column III is the FAS 95 treatment in the illustration.

Note how decreases in receivables become increases, and how decreases in accounts payable and long term debt become increases and their corresponding effects on cash flow.

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Appendix 2
Cash Flow Statement
with Exchange Rate Effect: Current Rate Method

I. The following shows the calculation of the cumulative translation adjustment, by balance sheet account, in the illustration (Current Rate Method):

1 Translated Balances @.020 12/31/89	2* Translated Changes @.014	1+2=3 Expected Balance 12/31/90	4 Translated Balances @.006 12/31/90	3-4 CTA Change
Cash \$ 400	\$ 28	\$ 428	\$ 132	\$ (296)
Rec. 680	784	1,464	540	(924)
Inv. 800	(140)	660	180	(480)
FA, net 1,600	(140)	1,460	420	(1,040)
A. Pay. (600)	(280)	(880)	(300)	580
L.T.D. (880)	(112)	(992)	(312)	680
Net \$ 2,000	\$ 140	\$ 2,140	\$ 660	\$ (1,480)

*The translated changes, as before, are the differences between the 12/31/89 and 12/31/90 amounts in the foreign currency multiplied by the average rate for the year. See I. above for an example.

II. Understanding the change in the cumulative translation adjustment on each balance sheet account allows preparation of a cash flow statement without the exchange rate effect removed and with the exchange rate effect removed (SFAS 95 treatment per the illustration) with reconciliation.

Foreign Operation
Translated: Current Rate Method
Cash Flow Statement

	I Exchange Rate Effect Unremoved	II Exchange Rate Effect	III FAS 95 ER Removed (illustration)
Income	\$ 140	-	\$ 140
Add Depreciation	140	-	140
	\$ 280		\$ 280
Receivables (dec)	140	\$(924) (inc)	(784)
Inventory (dec)	620	(480) (dec)	140
Acc. Payable (dec)	(300)	580 (inc)	280
From Operations	\$ 740	\$(824)	\$ (84)
Fixed Assets (dec)	1,040	(1,040)	-
Long Term Debt (dec)	(568)	680 (inc)	112
	\$ 1,212	(1,184)	\$ 28
Cumul. Trans. Adj.	(1,480)	1,480	-
Cash Change	\$ (268)	\$(296)	\$ 28
			\$ (296)
			\$ (268)

Column I, as before, is prepared using the translated balance sheets and income statements of Exhibit III. By removing the exchange rate effect calculated above (column II), balance sheet account changes are those resulting from the expected 12/31/90 balances. Accordingly, a reconciliation to the reported cash change is made at the bottom of column III. Column III is the FAS 95 treatment in the illustration.

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