

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) Translation exposure may also be called _____ exposure. 1) _____
A) operating B) accounting C) transaction D) currency
- 2) _____ exposure is the potential for an increase or decrease in the parent company's net worth and reported net income caused by a change in exchange rates since the last transaction. 2) _____
A) Translation B) Transaction C) Currency D) Operating
- 3) Translation exposure measures: 3) _____
A) the potential for an increase or decrease in the parent company's net worth and reported net income caused by a change in exchange rates since the last consolidation of international operations.
B) an unexpected change in exchange rates impact on short run expected cash flows.
C) changes in the value of outstanding financial obligations incurred prior to a change in exchange rates.
D) none of the above
- 4) According to your authors, the main purpose of translation is: 4) _____
A) to act as an interpreter for managers without foreign language skills.
B) to prepare consolidated financial statements.
C) to help management assess the performance of foreign subsidiaries.
D) none of the above
- 5) Historical exchange rates may be used for _____, while current exchange rates may be used for _____ 5) _____
A) equity accounts and current liabilities; current assets and fixed assets
B) current assets and liabilities; equity accounts and fixed assets
C) fixed assets and current assets; income and expense items
D) equity accounts and fixed assets; current assets and liabilities
- 6) If an imbalance results from the accounting method used for translation, the imbalance is taken either to _____ or _____. 6) _____
A) the bank; the post office
B) current income; equity reserves
C) current liabilities; equity reserves
D) depreciation; the market for foreign exchange swaps

- 7) Generally speaking, translation methods by country define the translation process as a function of what two factors? 7) _____
 A) location; foreign subsidiary independence
 B) foreign subsidiary independence; a firm's functional currency
 C) size; location
 D) a firm's functional currency; location
- 8) A/An _____ subsidiary is one in which the firm operates as an extension of the parent company with cash flows highly interrelated with the parent. 8) _____
 A) integrated foreign entity
 B) self-sustaining foreign
 C) foreign
 D) none of the above
- 9) Consider two different foreign subsidiaries of Georgia-Pacific Wood Products Inc. The first subsidiary mills trees in Canada and ships its entire product to the Georgia-Pacific U.S. The second subsidiary is also owned by the parent firm but is located in Japan and retails tropical hardwood furniture that it buys from many different sources. The first subsidiary is likely a/an _____ foreign entity with most of its cash flows in U.S. dollars, and the second subsidiary is more of a/an _____ foreign entity. 9) _____
 A) self-sustaining; integrated
 B) integrated; self-sustaining
 C) self-sustaining; domestic
 D) domestic; integrated
- 10) A foreign subsidiary's _____ currency is the currency used in the firm's day-to-day operations. 10) _____
 A) notational dollar
 B) integrated
 C) functional
 D) local
- 11) The _____ determines accounting policy for U.S. firms. 11) _____
 A) Financial Accounting Standards Board (FASB)
 B) Securities and Exchange Commission (SEC)
 C) Federal Reserve System (Fed)
 D) General Agreement on Tariffs and Trade (GATT)

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 12) It is possible to use different exchange rates for different line items on a financial statement. 12) _____
- 13) If the same exchange rate were used to remeasure every line on a financial statement, then there would be no imbalances from remeasuring. 13) _____
- 14) A foreign subsidiary's *functional currency* is the currency of the primary economic environment in which the subsidiary operates and in which it generates cash flows. 14) _____
- 15) It is *highly unusual* for a multinational firm to have both *integrated foreign entities* AND *self-sustaining foreign entities*. 15) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 16) The two basic methods for the translation of foreign subsidiary financial statements are the _____ method and the _____ method. 16) _____
A) current rate; future rate B) current rate; temporal
C) temporal; proper timing D) none of the above
- 17) Gains or losses caused by translation adjustments when using the current rate method are reported separately on the: 17) _____
A) consolidated income statement. B) consolidated statement of cash flow.
C) consolidated balance sheet. D) none of the above
- 18) The basic advantage of the _____ method of foreign currency translation is that foreign nonmonetary assets are carried at their original cost in the parent's consolidated statement while the most important advantage of the _____ method is that the gain or loss from translation does not pass through the income statement. 18) _____
A) temporal; current rate B) current rate; temporal
C) monetary; current rate D) temporal; monetary
- 19) Under the U.S. method of translation procedures, if the financial statements of the foreign subsidiary of a U.S. company are maintained in U.S. dollars: 19) _____
A) the translation method to be used is not obvious.
B) translation is accomplished through the current rate method.
C) translation is not required.
D) translation is accomplished through the temporal method.
- 20) Under the U.S. method of translation procedures, if the financial statements of the foreign subsidiary of a U.S. company are maintained in the local currency, and the local currency is the functional currency, then: 20) _____
A) translation is not required.
B) translation is accomplished through the temporal method.
C) translation is accomplished through the current rate method.
D) the translation method to be used is not obvious.
- 21) Under the U.S. method of translation procedures, if the financial statements of the foreign subsidiary of a U.S. company are maintained in the local currency, and the U.S. dollar is the functional currency, then: 21) _____
A) translation is not required.
B) translation is accomplished through the temporal method.
C) translation is accomplished through the current rate method.
D) none of the above

- 22) If the European subsidiary of a U.S. firm has net exposed assets of €750,000, and the euro drops in value from \$1.30/euro to \$1.20/€ the U.S. firm has a translation: 22) _____
 A) gain of \$625,000. B) loss of €576,923.
 C) gain of \$75,000. D) loss of \$75,000.
- 23) If the European subsidiary of a U.S. firm has net exposed assets of €200,000, and the euro increases in value from \$1.22/€ to \$1.26/€ the U.S. firm has a translation: 23) _____
 A) gain of \$252,000. B) loss of \$8,000.
 C) gain of \$8,000. D) loss of €252,000.
- 24) If the British subsidiary of a European firm has net exposed assets of £125,000, and the pound increases in value from €1.40/£ to €1.44/£, the European firm has a translation: 24) _____
 A) loss of £5,000. B) loss of €5,000. C) gain of £5,000. D) gain of €5,000.
- 25) If the British subsidiary of a European firm has net exposed assets of £250,000, and the pound drops in value from €1.35/£ to €1.30/£, the European firm has a translation: 25) _____
 A) gain of £12,500. B) loss of €12,500.
 C) gain of €12,500. D) loss of £12,500.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 26) Exchange rate imbalances that are passed through the balance sheet affect a firm's reported income, but imbalances transferred to the income statement do not. 26) _____
- 27) The current rate method is the most prevalent method today for the translation of financial statements. 27) _____
- 28) The temporal rate method is the most prevalent method today for the translation of financial statements. 28) _____
- 29) The biggest advantage of the current rate method of reporting translation adjustments is the fact that the gain or loss goes directly to the reserve account on the consolidated balance sheet and does not pass through the consolidated income statement. 29) _____
- 30) Under the temporal rate method, specific assets and liabilities are translated at exchange rates consistent with the timing of the item's creation. 30) _____
- 31) The temporal method of foreign currency translation gains or losses resulting from remeasurement are carried directly to current consolidated income and thus introduces volatility to consolidated earnings. 31) _____
- 32) : The *current rate method* and the *temporal method* are two basic methods for translation that are employed worldwide 32) _____

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

- 33) The two methods for the translation of foreign subsidiary financial statements are the current rate and temporal methods. Briefly, describe how each of these methods translates the foreign subsidiary financial statements into the parent company's consolidated statements. Identify when each technique should be used and the major advantage(s) of each.

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 34) Under U.S. accounting and translation practices, use of the current rate method is termed _____ while use of the temporal method is termed _____. 34) _____
A) remeasurement; translation B) translation; the same
C) translation; remeasurement D) remeasurement; the same
- 35) Which of the following primary principles of U.S. translation procedures is NOT true? 35) _____
A) If the financial statements of the foreign subsidiary are maintained in the local currency and the local currency is the functional currency, they are translated by the *temporal method*.
B) If the financial statements of the foreign subsidiary are maintained in the local currency and the U.S. dollar is the functional currency, they are remeasured by the *temporal method*.
C) If the financial statements of the foreign subsidiary of a U.S. company are maintained in U.S. dollars, translation is not required.
D) All of the above are true.

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 36) Under U.S. accounting and translation practices, use of the current rate method is termed "translation" while use of the temporal method is termed "remeasurement." 36) _____
- 37) If the financial statements of the foreign subsidiary are maintained in the local currency and the U.S. dollar is the functional currency, they are remeasured by the temporal method. 37) _____

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 38) The main technique to minimize translation exposure is called a/an _____ hedge. 38) _____
A) forward B) balance sheet
C) income statement D) translation
- 39) A balance sheet hedge requires that the amount of exposed foreign currency assets and liabilities: 39) _____
A) have a 2:1 ratio of liabilities to assets. B) be equal.
C) have a 2:1 ratio of assets to liabilities. D) have a 2:1 ratio of liabilities to equity.

- 40) If a firm's balance sheet has an equal amount of exposed foreign currency assets and liabilities and the firm translates by the temporal method, then: 40) _____
- A) the change in value of liabilities and assets due to a change in exchange rates will be of equal but opposite direction.
 - B) the net exposed position is called monetary balance.
 - C) Both A and B are true.
 - D) none of the above
- 41) If a firm's subsidiary is using the local currency as the functional currency, which of the following is NOT a circumstance that could justify the use of a balance sheet hedge? 41) _____
- A) The foreign subsidiary is operating in a hyperinflationary environment.
 - B) The foreign subsidiary is about to be liquidated, so that the value of its Cumulative Translation Adjustment (CTA) would be realized.
 - C) The firm has debt covenants or bank agreements that state the firm's debt/equity ratio will be maintained within specific limits.
 - D) All of the above are appropriate reasons to use a balance sheet hedge.
- 42) If the parent firm and all subsidiaries denominate all exposed assets and liabilities in the parent's reporting currency this will _____ exposure but each subsidiary would have _____ exposure. 42) _____
- A) eliminate translation; transaction
 - B) maximize transaction; no translation
 - C) eliminate transaction; translation
 - D) maximize translation; no transaction
- 43) A Canadian subsidiary of a U.S. parent firm is instructed to bill an export to the parent in U.S. dollars. The Canadian subsidiary records the accounts receivable in Canadian dollars and notes a profit on the sale of goods. Later, when the U.S. parent pays the subsidiary the contracted U.S. dollar amount, the Canadian dollar has appreciated 10% against the U.S. dollar. In this example, the Canadian subsidiary will record a: 43) _____
- A) 10% foreign exchange gain on the U.S. dollar accounts receivable.
 - B) 10% foreign exchange loss on the U.S. dollar accounts receivable.
 - C) Since the Canadian firm is a U.S. subsidiary, neither a gain nor loss will be recorded.
 - D) Any gain or loss will be recorded only by the parent firm.
- 44) _____ gains and losses are "realized" whereas _____ gains and losses are only "paper." 44) _____
- A) Translation; operating
 - B) Transaction; translation
 - C) Translation; transaction
 - D) none of the above

TRUE/FALSE. Write 'T' if the statement is true and 'F' if the statement is false.

- 45) It is possible that efforts to decrease translation exposure may result in an increase in transaction exposure. 45) _____
- 46) One possible reason for a balance sheet hedge could be because the foreign subsidiary is about to be liquidated, so that value of its Cumulative Translation Adjustment (CTA) would be realized. 46) _____

- 47) One possible reason for a balance sheet hedge could be because the firm has debt covenants or bank agreements that state the firm's debt/equity ratios will be maintained within specific limits. 47) _____
- 48) If management expects a foreign currency to *depreciate*, it could minimize translation exposure by *increasing* net exposed assets. 48) _____
- 49) If management anticipates an *appreciation* of the foreign currency, it should *decrease* net exposed assets to benefit from a gain. 49) _____

ESSAY. Write your answer in the space provided or on a separate sheet of paper.

- 50) Describe a balance sheet hedge and give at least two examples of when such a hedge could be justified.

Answer Key

Testname: UNTITLED2

- 1) B
- 2) A
- 3) A
- 4) B
- 5) D
- 6) B
- 7) B
- 8) A
- 9) B
- 10) C
- 11) A
- 12) TRUE
- 13) TRUE
- 14) TRUE
- 15) FALSE
- 16) B
- 17) C
- 18) B
- 19) C
- 20) C
- 21) B
- 22) D
- 23) C
- 24) B
- 25) C
- 26) FALSE
- 27) TRUE
- 28) FALSE
- 29) TRUE
- 30) TRUE
- 31) TRUE
- 32) TRUE

Answer Key

Testname: UNTITLED2

33) The current rate method translates almost all line items from the foreign subsidiary to the parent consolidated statements at the current exchange rate. This is the most commonly used method in the world today. Assets and liabilities are translated at current exchange rate and items found on the income statement are translated at the actual exchange rate on the date of transaction, or as an average over the statement period where appropriate. Equity accounts are translated at historical costs.

Any gains or losses caused by translation adjustments are typically placed into a special reserve account (such as a CTA). Gains or losses do not go through the income statement and do not increase the volatility of net income. This is perhaps the biggest advantage to using the current rate method.

By contrast, the temporal method assumes that several individual financial statement items are periodically restated to their market value. The temporal method translates individual line items based on monetary/nonmonetary criteria. Monetary assets such as cash and marketable securities are translated at current exchange rates, but nonmonetary assets such as fixed assets are translated at historical rates. The gains or losses that result from translation remeasurement are recorded on the consolidated income statement and impact upon the volatility of net income. The temporal method of using historical costs may be more consistent with the practice of carrying domestic items at cost on the financial statements.

34) C

35) A

36) TRUE

37) TRUE

38) B

39) B

40) C

41) D

42) A

43) B

44) B

45) TRUE

46) TRUE

47) TRUE

48) FALSE

49) FALSE

50) A balance sheet hedge attempts to equalize the amount of assets and liabilities of a foreign subsidiary exposed to translation risk. Thus, the gain to the firm from a change in exchange rates will be perfectly offset by an equal and opposite loss. Firms may engage in balance sheet hedges under conditions of hyperinflation, or when the subsidiary is about to be liquidated and the value of the CTA account would be realized. The author on page 16 lists other examples.