〈논　　문〉

Foreign Currency Translation in East-West Joint Venture

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Introduction

Translation of the financial statements of joint ventures is necessary when using the equity method of accounting and preparing combined or consolidated financial statements in a common currency. This is a barometer to evaluate the operations and management of a joint venture. That is to say, it is not only a tool for multinational corporations to direct and control foreign operations; but also an instrument for stockholders and other users to assess the productivity of a joint venture in the framework of a familiar currency. The issue of foreign currency translation is a sensitive one not only because correct calculation of the profits or losses of a joint venture is important, but also because it is significant, particularly to the Western co-venturers, in that they should report the state of the venture to their stockholders, or other investors. The purpose of this paper is to investigate state practice relating to foreign currency translation in East-West joint ventures, and to examine whether the translation methods are appropriate in terms of the prevailing international accounting standards.

I. Problems in Applying Various Methods of Translation

Translation methods may be based on the use of historical rates for some items and of the closing rates for others (historical rate method), or alternatively the use of the closing rates for all itms (closing rate method, a current rate method). Two of the methods which use historical rates are the current-noncurrent method and the monetary-nonmonetary method. Under the current-noncurrent method, current assets and current liabilities are translated

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at the current exchange rate or closing rate in effect at the balance sheet date, while noncurrent assets, long-term liabilities and stockholders' equity are translated at the historical exchange rate, *i.e.*, the rate in effect when the asset was acquired or liability incurred and thus first recorded in the books of the enterprise. This current-noncurrent method was advocated by the AICPA in June 1953 when foreign currencies fluctuated in relation to the U.S. dollar. This method was also predominantly used in the Continental Europe and Japan. This method, however, merely represented the nature of foreign operations and foreign currencies that prevailed until 1960.[1]

The current-noncurrent method was soon reexamined and challenged by the supporters of the monetary-nonmonetary method by the mid-50's when inventories represented on the average upwards of one-fourth of the total assets of foreign operations. The challenger argued that the current-noncurrent method often violated the basis of historical cost and the rule of lower-of-cost-or-market in U.S. dollars. They further argued that the translation of long-term debt using historical rates only postponed the recognition of gains and losses. Supporters of the monetary-nonmonetary method, such as Samuel Hepworth,[2] suggested that monetary assets and liabilities should be translated at the current (year-end) rate and that nonmonetary assets and liabilities at the historical rates on the ground that the former were considered to be susceptible to and immediately affected by changes in money prices whereas the latter were not necessarily affected. Subsequently, the Accounting Principles Board in 1965 effectively authorized the use of this monetary-nonmonetary method is an alternate practice by accepting the current rate for translation of long-term receivables and payables.[3] This method was widely used in the United States before FASB standard No. 8.

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(1) *See generally* Elwood L. Miller, Accounting Problems of Multinational Enterprises (Lexington, Mass. 1979)

(2) *See generally* Samuel R. Hepworth, Reporting Foreign Operations (Ann Arbor, Univ. of Michigan, 1956)

(3) *See* Accounting Principles Board Opinion 6, "Status of Accounting Research Bulletins" (New York, AICPA, 1965), para. 8

The monetary-nonmonetary method, however, proved to be too flexible to provide acceptable accounting information to the public. This method also became not adequate after the breaking-down of the Bretton Woods system in early 1970's. In 1972, Lorensen proposed the temporal method by modifying the monetary-nonmonetary method in light of the accounting principles generally accepted in the U.S. GAAP, which requires the use of historical costs.[4] This temporal method attempts to retain the aspect of time-related transactions: the current rate is applied to items carried at present or future prices, such as, cash, receivables, payables; historical rates are used with all items carried at cost, such as, plant, equipment, inventories. This method was adopted in the FASB Statement 8 in October 1975.

This FAS 8 became highly controversial not only because of its call for the necessity of restrictive standardization of translation practices, that is to say, "a single consistent and uniform standard for all firm," based on the GAAP, but also because of its allegedly inherent defects:

(1) It unduly emphasizes fluctuations in exchange rates by reporting exchange gains and losses and translation adjustments in current income.

(2) It results in reported (accounting) foreign currency exposure that is inconsistent with the concurrent economic exposure.

(3) It fails to recognize extensive economic hedges of foreign exchange risk exposure.

(4) It distorts the normal relationship within the financial statements of foreign subsidiaries or divisions.[5]

Based on the numerous criticisms, the FASB reconsidered FAS 8, and issued an Exposure Draft in August 1980. Instead of the previous objectives of translation to measure and express in U.S. dollars in conformity with the U.S. GAAP, the Board proposed to do so in the functional currency of each component entity.[6] Under this concept, the functional currency, as the most

(4) *See* Leonard Lorensen, Accounting Research Study No. 12., "Reporting Foreign Operations of U.S. Companies in U.S. Dollars" (New York, AICPA, 1972)

(5) *See* Deloitte, Haskins & Sells, Foreign Currency Translation (August 28, 1980), at 7.

(6) *See* 1980 Exposure Draft, para. 6(a).

appropriate to the economic environment in which a foreign entity operates, is used as the basis for its accounts prior to translation.[7] Thus, the 1980 Exposure Draft subordinates theoretical adherence to an overall GAAP model to a more practical and generally acceptable approach in adopting the current method more generally used outside the United States.

Under this Exposure Draft, all assets and liabilities would be translated at the current rate.[8] Thus, the value of fixed assets, expressed in U.S. dollars, will vary depending upon the current rate. This current rate method, which preserves existing financial ratios, has been widely used in the United Kingdom and elsewhere in Western Europe. As a result of translating the entire financial statement at one current exchange rate, the large foreign-currency-translation gains and losses and the volatility of changes in net income which many corporations have experienced under FAS 8, would be diminished.

The 1980 Exposure Draft has been critical in many points. For example, the minority members do not support the proposed statement because it adopts objectives at variance with the single unity and single unit measure concepts that underlie consolidated financial statements. In their view, the proposed standards are at variance with the stated objectives, and has the potential to reduce the credibility of financial reporting. The dissenters share the extreme difficulty of developing standards for foreign currency translation, but they would support a proposal that "adopted objectives of translation that retained the concept of a single consolidated entity and a single unit of measure," and that "essentially retained Statement 8's translation method, with an exception being translation of locally sourced inventory at the current rate."[9]

Despite the criticisms, the FASB decided in 1981 to retain the basic approach to foreign currency translation in the 1980 Exposure Draft and proceeded to address only possible modifications to the previous approach. The 1981 Exposure Draft introduces the current rate method of translation just like 1980 Draft

(7) *See* 1980 Exposure Draft, paras. 15-17.
(8) *See* 1980 Exposure Draft, para. 9.
(9) *See* 1980 Exposure Draft, para. 104 (a), (b).

and the "translation adjustments" category of equity for those foreign operations for which the functional currency is a currency other than the U.S. dollar.[10] The 1981 Draft introduces a new method of inflation accounting and a new entry to equity as a requirement in the basic financial statements for some foreign operations and as an option for others.[11]

Dissenters, however, believe that more meaningful consolidated results could be attained by measuring costs, cost recovery, and exchange risk from the U.S. dollar perspective rather than from multiple functional currency perspectives. They repeated the same arguments as attached to the 1980 Exposure Draft. They further argued that improved financial reporting would have resulted from an approach that avoided creating direct entries to equity and introducing inflation accounting into the basic financial statements.[12] They also believed the functional currency perspective rejects the U.S. dollar perspective that underlies existing theories of consolidation, historical cost and capital maintenance, business combinations and inflation accounting.[13] According to them, the aggregation of results first measured in various functional currencies and then translated into U.S. dollars by the current rate method along with disposition of resulting adjustments directly to equity abandons the long-standing principle that "consolidated results should be measured from a single perspective rather than from multiple perspective."[14]

Despite such criticisms, the 1981 Exposure Draft appears to be an improved one in the sense that it provided detailed rules relating to the determination of the functional currency disposition of exchange adjustments on intercompany transactions and balances, disposition of exchange gains and losses on foreign currency transactions that are a hedge of a net investment or a foreign currency commitment, and possible disclosure of the effects of rate changes on

(10) *See* 1981 Exposure Draft, paras. 5-11, 75-82, 108-117.
(11) *Id.*, paras. 12-14, paras. 100-107.
(12) *See* 1981 Exposure Draft, para. 149.
(13) *Id.*, para. 150.
(14) *Id.*, para. 152.

reported revenue and earnings.[15] It also newly stipulated detailed provisions relating to translation of operations in highly inflationary economies, taking account of fact that numerous commentators to the 1980 Exposure Draft pointed out that "unless special provisions are made, the proposed translation method could report misleading results."[16] The FASB correctly suggested that the foreign financial statements should be restated from nominal currency units to general price-level adjusted units before translation.[17]

There still exists, however, another method of translation, which is called as statistical or convenience translation method. In this method, all financial statement amounts are translated by the same coefficient for the sole convenience of a reader accustomed to a particular measurement unit. For example, financial statements, maintained in a foreign currency by a foreign company planning to file a registration statement with the U.S. SEC(Securities and Exchange Commission), and used in raising public funds in the United States, should be translated into U.S. dollars at the current rate.[18]

In practice, however, several hybrid mixtures are found which incorporate two or more of the above mentioned methods. It appears that the first two methods—current-noncurrent method, monetary-nonmonetary methods—are rather outdated. There still exist debates as to the objective of translation and therefore as to whether the temporal method or the current rate method should be adopted as the standard. Exposure Draft 11 of the International Accounting Standards Committee (IASC) states that "it is not possible to select only one of the two methods as the international standard and to expect universal acceptance."[19] Thus, the IASC accepts either of these two methods but requires disclosure in the financial statements of the method adopted. For

(15) *See* 1981 Exposure Draft, para. 177.
(16) *Id.*, para. 104.
(17) *Id.*, para. 105.
(18) *See* Guide 24 of the Guides for Preparation and Filing of Registration Statements, SEC. Act Rel. No. 4936 (Dec. 9, 1968).
(19) *See* Exposure Draft 11, Proposed Statement: Accounting for Foreign Transactions and Translation of Foreign Financial Statements (issued for comments by the International Accounting Standards Committee on December 1, 1977), para. 17.

the purpose of translation in joint ventures, monetary-nonmonetary method appears to be better than current-noncurrent method because contributed assets are differentiated between monetary-nonmonetary assets in evaluation.

Temporal method seems to be an improved one compared with the above two methods, because it emphasizes time factors for sophisticated choice of translation rate. In certain instances, when the underlying accounting system is historical cost-based, temporal method would produce similar results to the monetary-nonmonetary method.

Compared with the temporal method, the current rate method could be more appropriate in case a joint venture adopts the equity method in the financial statements, in the sense that the current rate, the rate in effect at the foreign entity's balance sheet date, would be useful to the equity method of accounting.

II. Search for Appropriate Methods of Accounting for Exchange Gains and losses

Gains and losses from foreign currency fluctuation appear with greater frequency in income statements, sometimes making the critical difference between higher or lower earnings per share. Risks of losses resulted from foreign exchange fluctuations became much greater when the Bretton Woods system collapsed and the era of floating exchange rates commenced in 1973. During the fixed exchange rate days under Bretton Woods system, there were seldom any profits or losses recorded in translating corporate accounts from frauds or other foreign currency into dollars. Even under the floating system, a firm could smooth the earnings impact of exchange fluctuations by setting up a reserve. However, problem arose when FASB established new rules for translating foreign currency transactions and financial statement items into dollars, to the effect that unrealized translation gains and losses be treated as part of quarterly income. Thus the gains and losses became highly visible. The ever-increasing magnitude of overseas operations with their newly-

found visibility on the quarterly income statement became problematic, because of those gains and losses explained at shareholder meetings and by other decision-makers. The risk of exchange loss has become more significant, mainly because the spread between the spot, forward and future exchange rates has been wider in recent years. Employment of different methods of translation will of course result in significant difference in the financial statement.

The current-noncurrent method generally produces a deferred situation in relation to devaluation or depreciation, whereas monetary-nonmonetary method allows exchange gains to arise in relation to devaluing currencies. These two methods were originally recommended by the FASB for the translation of the balance sheet. The temporal method and the closing rate approach were recommended primarily for the income statement translation. When the temporal method is used, gains and losses on translation are usually included in net income for the period in which they occur. Long-term monetary items are, however, not realized currently, and the gain or loss is subject to the uncertainty of future movements in exchange rates. Such gains or losses are sometimes excluded from net income for the period and are reported either as changes in shareholder's interests or deferred. Thus, the excluded amount from net income may be either: (a) the total gain or loss for the period on translation of long-term monetary item, or (b) all gains on translation of such items and losses on translations only to the extent of previously deferred gains.[20] FASB No. 8 also requires that the full impact of these gains and losses be reflected in the current income statement.[21] Under the temporal method no gain or loss will arise with respect to a nonmonetary item that is carried in the financial statements at its historical cost. In circumstances where such an item is reported in the statements at a revalued amount which has been substituted for historical cost during the current period, the net adjustment may be considered to relate either to the revaluation, or to the translation

(20) *See* IASC Exposure Draft 11, para. 21.
(21) FASB Statement No. 8 (October 1975), para. 17.

of that item, or in part to each.[22]

When the current (closing) rate method is used, the net gain or loss on translation is usually included in net income for the period. However, gains and losses on translation sometimes cannot be included in the determination of net income because of the uncertainty of their future realization. In such cases, the gains and losses may be reported as changes in shareholder's interests or deferred. The amount of the gain or loss so treated may be limited to that portion of the total gain or loss relating to either the net shareholders' equity at the beginning of the period or to the net amount of long-term assets and liabilities of the enterprise.[23] Although all gains on translation losses are excluded, the exclusion of losses may be restricted to the amount of previously deferred gains.[24]

According to the terms of the 1980 Exposure Draft, gains and losses would be translated to produce approximately the amounts resulting from translation effected as of their date of occurrence.[25] At each balance sheet date, all accounts denominated in foreign currency would be translated into dollars at the rate of the balance sheet date. If the exchange rate changes during the year, the dollar value of the items denominated in foreign currency would have to be adjusted. This adjustment should be shown on the income statement as realized gains or losses.[26] Two exceptions to the current inclusion in net income of exchange gains and losses would be: (a) a foreign currency transaction intended to be an economic hedge of a net investment in a foreign entity, and (b) adjustments attributable to foreign currency balances and foreign currency transactions made during intercompany financial statement consolidation. In these cases the non-included gains would be added to the special stockholders' equity account[27] Application of the current rate

(22) IASC Exposure Draft 11, para. 22.
(23) *Id.* para. 24.
(24) *Id.* para. 25.
(25) 1980 Exposure Draft, para. 9.
(26) *Id.* para. 14.
(27) *Id.* para. 18.

method would diminish the large foreign currency translation gains and losses and the volatility of changes in net income, which were common under FASB 8. Under the new system, net translation gains and losses will still remain, but generally would not be reported in the income statement as realized gains and losses.

The 1981 Exposure Draft follows the basic philosophy embodied in the 1980 Draft. The FASB concluded that transaction gains or losses should be reflected in income when the exchange rates change. The FASB rejected a proposal that a transaction gain or loss should be deferred if the rate change that caused it might be reversed before the transaction is settled.(28) The FASB also saw no basis for an alternative proposal for recognition of transaction gains or losses when unsettled balances are classified as current assets and liabilities, because such a requirement would put emphasis on the balance sheet classification or settlement date rather than on the economic effect of the exchange rate.(29) The FASB takes the view that transaction gains and losses on amounts borrowed in a currency might be considered part of the cost of the borrowed fund.(30) As to transaction gains and losses attributable to settled and unsettled intercompany foreign currency transactions, the 1981 Exposure Draft states that transactions and balances that are of a long-term financing or capital nature are considered to be part of the net investment. Related adjustments are to be reported and accumulated in the same separate component of equity as are translation adjustments when financial statements for those entities are consolidated, combined, or accounted for by the equity method. Transaction gains and losses attributable to other intercompany transactions and balances affect functional currency flows. Increases or decreases in actual and expected functional cash flows should be included in determining net income for the period in which exchange rates change.(31) The 1981 Exposure Draft also

(28) *See* 1981 Exposure Draft, para. 123.
(29) *Id.* para. 124.
(30) *Id.* para. 125.
(31) *See* 1981 Exposure Draft, para. 129.

suggests that the use of average rates or other methods should be examined to translate gains and losses as well as revenues and expenses. It recommends that average rates should be appropriately weighed by the volume of functional currency transactions occurring during the accounting period.[32] Dissenters to the 1981 Exposure Draft takes the view that in financial reporting all gains and losses in net income should be recognized, and separately presented within the income statement. They cannot support the 1981 Draft relating to gains and losses on the ground that it builds on two incompatible premises producing anomalies and a significant but unwarranted reporting distinction between transaction gains and losses and translation adjustments. They further argues that it incorrectly assumes that when assessing future cash flows to them, U.S. investors and creditors are more interested in measurements of net income from a perspectively multiple functional currencies rather than net income measured in U.S. dollars so that it inappropriately measures gains and losses based on the effects of exchange rate changes between foreign currencies rather than based on the effects of changes between the U.S. dollar and the foreign currencies.[33] The major difference between the 1981 Exposure Draft and the 1980 Exposure Draft is the disposition of exchange gains and losses on foreign currency transactions that are a hedge of a net investment or a foreign currency commitment.[34]

III. Recent Development of International Accounting Standards

Efforts to achieve universal standardization of accounting principles and methods have been undertaken at the UN and several other private organizations since 1973. Among them, the contributions by the International Accounting Standards Committee (IASC), established in 1973 by the major accountancy bodies of 9 countries and associate member organizations from 26 countries, have been most conspicuous. The objectives of the IASC have been to formulate

(32) *Id.* para. 9, 13.
(33) *See* 1981 Exposure Draft, para. 149 (b)(c).
(34) *Id.* paras. 21(a), 22, 126-128, 130, 131.

and publish basic standards to be observed in the presentation of audited accounts and financial statements, and to promote their world-wide acceptance and observance. The standardization efforts of the IASC have focused on the limited number of essential issues. The IASC has so far issued 13 statements and 6 exposure drafts.

The IASC issued an Exposure Draft (E 11) concerning Accounting for Foreign Transactions and Translation of Foreign Financial Statements on December 1, 1977. This Exposure Draft is composed of only 6 paragraphs along with a rather extensive explanations regarding some fundamental principles and methods which are thought to be already established in many countries. The 1977 Exposure Draft deals with financial accounting for, and reporting of, transactions in foreign currencies in the financial statements of a reporting enterprise. It also deals with accounting and reporting for the foreign currency translation of the financial statements of foreign-based operations, for the presentation of combined or consolidated financial statements, or for accounting under the equity method. However, it does not deal with the translation of the financial statements of an enterprise from its reporting currency into another currency for the convenience of readers.

According to the terms of the Draft, foreign currency translation should be recorded in the reporting currency at the foreign currency amounts multiplied by the foreign exchange rates existing at the time of transactions.[35] The forward exchange rate specified in a foreign exchange contract may be used to record a transaction in a foreign currency if the forward contract is entered into in order to establish the amounts of the reporting currency at the date on which the foreign currency transaction is settled.[36] At each balance sheet date, monetary items of receivables or payables in foreign currencies should be reported at the closing rate except when the foreign monetary item specifically covered by a forward exchange contract. In this exceptional case,

(35) *See* IASC Exposure Draft, para. 27.
(36) *Id.*, para. 28.

the item should be reported at the rate specified in that contract. When there is a change in the exchange rate between the transaction date and the settlement date for a monetary item.[37] Strangely enough, the IASC did not suggest a single method of translation, but recommended either the temporal method or the closing rate (current) method in translating the financial statements of foreign-based operations into the reporting currency.[38] Despite the substantial differences between the two methods, the IASC was indecisive. They suggested the two alternatives, probably because of the heated debates over the two competing methods, since the issue of FASB No. 8 in October 1975. Since the FASB issued the 1980 Exposure Draft, adopting the current rate (closing rate) method, there has arisen certain movement in the IASC to follow the pattern of the Exposure Draft. After the issue of the 1981 Exposure Draft, which adhered to the current rate method, the IASC's position became confirmed. The IASC prepared another Exposure Draft in 1981 closely following the 1981 Exposure Draft by the FASB.

Following the principles stated in the Disclosure of Accounting Policies published in January 1975, the IASC declared in the 1977 Exposure Draft that "the accounting policies adopted for the translation of the financial statements of foreign-based operations and for the treatment of foreign exchange gains and losses should be disclosed in the financial statements."[39] Separate disclosure is required of the following items: (a) the aggregate foreign exchange gain or loss originating in the current period indicating the amount included in net income for the period, stockholders' equity, or deferred, (b) the aggregate foreign exchange gain or loss included in net income for the period, (c) the amount of change in stockholders' equity or in deferred gain or loss arising from the translation of monetary or nonmonetary items, (d) the amount of any deferred gain or loss existing at balance sheet date, (e) the method of

(37) *Id.*, para. 29.
(38) *Id.*, para. 30.
(39) *Id.*, para. 31. See also IASC, Disclosure of Accounting Policies (IAS 1) (1975).

accounting for any accumulated deferred gains or losses on translation.[40] According to the new 1981 Exposure Draft, the temporal method is used in cases where the relationship of the foreign entity is integrated to the parent, whereas the closing rate method (current rate method) in cases the relationship is not integral. The dividing line between the two is to be decided on the basis of five factors listed in the draft.[41]

IV. Appropriate Methods of Translation for East-West Joint Venture

All of the five East European countries, which enacted joint venture laws, provided rules concerning foreign currency regulation. Since they are generally suffering from lack of hard currency, their restrictions are tight. Among them, the Yugoslavian legislation appears to be most attractive to foreign investors. Since any joint venture would exercise the same rights as any other Yugoslav work organization, it can participate in the various social compacts and federal social plans. Similar degree of independence is found in the Yugoslav foreign exchange regime. Such a joint venture can participate in a Self-Managing Community of Interest for the handling of foreign exchange with other organizations of associated labor.[42] Its entitlement to foreign exchange quotas and its obligation to share the foreign exchange which it has earned can be established in mutual agreements reached with other organizations of associated labor.

Romania tried to establish a joint venture regime following the successful example of Yugoslavia, but Romanian joint ventures are much more restrictive. Romania enclaves joint ventures from the domestic economy in order to meet the primary goal of creation of convertible currency exports through them. joint Thus, the financial operations that must be transacted with convertible currency include purchases and sales abroad as well as salaries of the foreign

(40) *Id.* para. 32.
(41) Interview with Mitchell Jaiven at the U.S. branch of the IASC on Sept. 8, 1981.
(42) *See* The Law on Foreign Credit Relations (1977), Arts. 37-45.

and local employees and other expenses in Romania.[43] The joint venture is even required to formulate annual and five-year programs of economic and financial activity.[44] Transactions of the joint venture involving transfer of funds are computed at the noncommercial rate of exchange, which is used for all trade transactions and tourism. These cumbersome requirements coupled with the double barreled exchange rates have discouraged possible active participation of the potential Western partners.

Similar enclave policies can be found in the Hungarian joint venture legislation. The amended 1979 decree limits the joint venture's access to the domestic market only to the extent that it may engage in "wholesale and production means stockpiling" unless the joint venture obtains an exemption from the Ministry of Trade.[45] The foreign currency exchange transaction takes place by the employment of the commercial currency rate determined by the National Bank of Hungary.[46] However, the Minister of Finance may approve the employment of noncommercial exchange rates case by case. Despite the amendments, the Hungarian joint venture decree is still too vague and restrictive to draw sufficient interests from potential Western partners.

The 1980 Bulgarian joint venture law is also vague and flexible. A joint venture in Bulgaria may conduct its activities both in Leva, the local currency, and in any convertible currencies. The joint venture decree states that "the coordination of the activities of the corporation with the planning, foreign currency-financial, trading and other state and social organs" within Bulgaria is carried out by the Bulgarian partner.[47] The specific mode of this coordination will be decided by joint venture agreements, but normally the Bulgarian

(43) *See* Decree No 424 on Constitution, Organization and Operation of Joint Companies in the Socialist Republic of Romania, Arts. 23-25.

(44) *Id.*, Art. 8.

(45) Decree of Finance on Economic Associations with Foreign Participation (No. 28 of 1972, amended by No. 7 of 1977, amended again by No. 5 of 1979), Art. 8(2).

(46) *Id.*

(47) *See* Decree No. 535 on Economic Cooperation between Bulgarian Juridical Persons and Foreign Juridical and Physical Persons (1980), Art. 13.

authorities which approve the agreements also determine the possible integration of the joint venture into the domestic market. Rules for conditions are required to be fixed in the joint venture agreement.

Under the 1979 Polish joint venture law, the joint venture is a part of the domestic economy, but remains independent of the planning system of ministries and industrial associations.[48] Polish administrative units issue foreign currency permits for corporate bodies or individuals being the partners of those companies. The currency permits will be issued in the scope of foreign currency granted by the Ministry or by the Board of Central Union of cooperative society, the same which made the decision on the setting-up of the company within its own currency limitations.[49]

In clearing the transactions made in convertible foreign currency, a special exchange rate by the National Polish Bank must be used.[50] The joint ventures may repatriate their earnings, deposited in their "current currency account" in the Bank, to other countries in convertible currencies on certain conditions.[51] To translate zlotys into convertible currencies and convertible currencies into zlotys, special rates of exchange set by the Polish National Bank shall be applied.[52]

A major difficult part of the negotiation for the establishment of a joint venture with Eastern European partners has been the question of whether transactions are to be recorded in local currency, foreign currency, or both via a dual bookkeeping system. These provisions are of crucial importance because one of the major advantages of a joint venture from the Western company's point of view is the chance to get hardcurrency returns on soft-currency sales in Comecon.[53]

As to foreign currency translation, there has been no consistent approach:

(48) The [Polish] Resolution No. 24 of the Council of Ministers (1979), Arts. 6, and Annex Arts. 35-37.
(49) *Id.* Art. 24.
(50) *Id.* Annex Art. 13.
(51) *Id.* Annex Art. 26.
(52) *Id.* Annex Art. 30.
(53) *See* Business Eastern Europe (April 25, 1981), at 130.

historic or current rates have been used, depending upon how the parties agree. However, it is to be noted that in absolute majority of cases the current rate method has been employed.[54] As a matter of fact, the current rate method has mostly been used in Western Europe, probably because it is relatively easy to use in manual accounting. It is also logical and useful to spot the state of the business at the balance sheet date. However, the usage of the temporal method has been generally limited to the United States in recent years. The IASC adopted both the temporal method and the current rate method, so that one of them can be chosen by mutual agreement. It is said that even the IASC has changed its previous attitude and adopted the current rate method in the new 1981 Exposure Draft.

For reporting requirement, the current rate method has generally been used. For the purpose of repatriation of hard currency, method of translation varies depending upon the designation of functional currency. For example, if Yugoslav dinar is a functional currency, the current rate method would be all right, but in case U.S. dollar is a functional currency, index adjustment should be carried on. Because of the lack of hard currency, Eastern European countries limit repatriations to a varying degree.[55]

Conclusion

There are two kinds of problems relating to gains and losses in East-West joint venture. First problem relates to gains and losses resulted through translation of fixed assets and payables. In the case of reporting, such gains and losses would not go through income statement, but should be treated separately as a shareholders' equity. Second problem relates to the gains and losses resulted from East-West trade activity. In this case, the gains and losses should be reflected in the income statement. This is a good contrast to U.S. accounting standard. FASB No. 8 states all sorts of translations should be carried in the

(54) Interview with J. Gale at Coopers & Lybrand, New York on Sept. 11, 1981.
(55) Interview with Mr. Money at Coopers & Lybrand Richmond, on Sept. 11, 1981.

income statement. However, the 1981 Exposure Draft states that they should not be carried into the income statement, but stated separately. The IASC's new draft closely followed the 1981 FASB Exposure Draft. As to the problem of currency translation there have so far been no specific provisions stipulated in any local legislation in the Eastern European countries. It is basically a matter of negotiation.