1989

Interrelationship between Taiwanese and American currencies| Present accounting practices and future suggestions

Shufen Hu

The University of Montana

THE INTERRELATIONSHIP BETWEEN TAIWANESE AND AMERICAN CURRENCIES -- PRESENT ACCOUNTING PRACTICES AND FUTURE SUGGESTIONS

By

Shufen Hu

B.B.A., National Cheng-Kung University, 1980

(Tainan, Taiwan, R.O.C.)

Presented in partial fulfillment of the requirements for

The degree of

Master of Accountancy

University of Montana

1989

Approved by:

Chairman, board of examiners

Dean, graduate school

August 15, 1989

Date

TABLE OF CONTENTS

LIST OF APPENDICES

CHAPTER I.

INTRODUCTION

As one of the "four dragons," Taiwan, a small island nation with a land area of only 13,900 square miles and a population of 20 million, is well aware of rising international trade tensions. Regardless of these increasing tensions, Taiwanese are proud of their country's economic development and high rate of economic growth, a considerable degree of price stability, a very low unemployment rate, and a huge trade surplus.

Taiwan has limited natural resources. While more than 70 minerals are found in Taiwan, only coal is relatively abundant.[1] Due to its limited natural resources, Taiwan has exhibited an economic development pattern in the past three decades which has included four major structural transformations: (1) agricultural reform, (2) import-substitution industrialization, (3) export-led growth, and (4) changing from labor-intensive to technology-intensive production.[2] These structural transformations have necessarily given rise to specific economic concerns. Two major concerns are the inordinate reliance upon the supply of foreign raw materials and the development and expansion of foreign export markets.

With a total volume of trade amounting to US$110 billion (exports accounting for US$60 billion and imports accounting for US$50 billion), Taiwan was the thirteenth largest trading nation in the world in 1988. Bilateral trade between Taiwan and the United States reached US$36.43 billion, making Taiwan America's fifth largest trading partner.[3] Among Taiwan's trading partners, the United States ranks first. (Appendix I) However, trade friction between Taiwan and the United States is a major economic concern to Taiwan.

Since September 1985, the New Taiwan (NT) dollar, driven largely by American political pressure, has risen by 40 percent against the U.S. dollar. Prior to September 1985, the spot exchange rate between them held steady at or around $40 NT to $1 US for several years. (Appendix II) The appreciation of the NT dollar, combined with a somewhat strained trading relationship with the United States, has considerably weakened Taiwan's economic position.

Although Taiwan has a good foreign trade standing and a successful economic development plan, the appreciation of the NT dollar has very much affected Taiwan's ability to compete in the international economic arena. The resulting erosion of its competitive position has led to modest inflationary pressures. So far, however, even with an appreciated NT dollar, inflation has been kept to a minimum. Nevertheless, inflation is of grave concern to the Taiwanese government and people.

In facing this serious problem, Taiwan's businessmen are dedicating themselves to minimizing the exchange-rate risk involved. At the same time, the government is providing some incentives and recommendations to assist businesses in maintaining their competitiveness. Along these lines, Taiwan has taken steps to diversify and expand its foreign trade markets beyond the United States. It has sought greater trade with the European Economic Community and has recently initiated trade with eastern Europe. Furthermore, Taiwan has aggressively begun to promote trade with Third World countries. In addition to trade market expansion, and in an attempt to limit further appreciation of the NT dollar, the Taiwanese government has offered supports in the form of economic incentives to encourage businesses to invest abroad.

As the amount of Taiwan's foreign investment increases (Appendix III) and as the NT dollar continues to appreciate, financial executives of Taiwanese companies are faced with several problems. These include the remeasurement of operating results from their foreign operations and consolidating the results of their foreign and domestic operations in a manner that will produce meaningful consolidated financial information. This task is complicated by the fact that the financial records of a company's foreign and domestic operations are maintained in different currencies. The interrelationship between these currencies is constantly changing.

The lack of a stable basis of translation has led to a number of additional problems. They run the gamut from the question of the appropriate exchange rate to use in each case, to the question of what the translated results are actually communicating to the statement users.

The purpose of this paper is to study some of these issues. After a discussion of cultural influences and other factors affecting business in Taiwan, this study will examine the Taiwanese accounting system, the foreign currency issue, foreign exchange risk management, and the financial reporting of foreign currency translation. By confronting the foreign currency issue, Taiwan will solve a problem that greatly affects its own international trade and in so doing, will enhance its prospects for greater economic success.

CHAPTER II.

ENVIRONMENTAL CONTEXTS OF TAIWAN'S BUSINESS AND ACCOUNTING

Enterprises operating internationally both are affected by, and have an immense impact on, the environments in which they operate. Today in Taiwan, business is conducted among organizations within virtually every conceivable institutional framework.

The most common form of business organization in Taiwan is the small or medium-sized company. There are 700,000 businesses in Taiwan. Ninety-eight percent of them are classified as "small" and "medium" (see Appendix IV) --meaning that either their operating capital[4] or annual business revenue was less than NT$40 million.[5]

This paper examines several characteristics of these "small" or "medium" businesses. These include the internal and external factors affecting Taiwanese attitude toward business. Other key factors are the accounting method used by Taiwanese businesses, and the organizations which provide guidance and standards for accounting methodology.

A. Factors Influencing Taiwanese Business

1. International Influences

After the civil war with Communist China in 1949, the Kuomintang, the only political party before 1987, rehabilitated Taiwan's economic infrastructure. The first four-year economic development plan in the early 1950s was the expansion of import-substitution industries. But as soon as government leaders recognized the bottleneck presented by the narrow, domestic market, they quickly switched to developing an export-promotion strategy, which came into full bloom in the mid-1960s.[6] Today, Taiwan's economy is considered one of the world's most open in terms of its foreign trade's share of total Gross Domestic Product (GDP). In 1987, exports accounted for 55 percent of the GDP, and the trade surplus accounted for 18 percent. (Appendix V)

In order to obtain a larger world market share and to diversify the export market, Taiwan's businesses had to promote direct investment overseas. The first foreign investment was built in Malaysia in 1959. However, large-scale Taiwanese investment abroad did not begin until 1970. After September 1985, foreign investment became even more significant for Taiwanese businesses because they had to avoid problems resulting from the appreciating NT dollar. Since that time, many Taiwanese businesses have established foreign branches or subsidiaries abroad. (Appendix III) According to the government statistics of Thailand, Malaysia, the

Philippines, and Indonesia, in 1988 Taiwanese investments were ranked second in each country, a total amount equal to US$2 billion.[7]

In terms of trade relations, from 1951 to 1965, Taiwan received financial economic aid from the United States amounting to US$2 billion. Since that time, the United States has purchased a substantial quantity of Taiwanese goods and has provided a considerably lower tariff policy to support Taiwan's economic development.[8]

Through 1988, the United States was the largest buyer of Taiwan's goods and its second largest supplier of goods. (Appendix I) For example, in 1988 the total Taiwan-U.S. trade amounted to US$36.43 billion. This represented 33 percent of Taiwan's total trade that year. This is the reason why many Taiwanese feel the U.S. dollar is their country's foreign currency.

In terms of foreign policy, very few nations have formal diplomatic relationships with Taiwan. However, foreign economic relations play an important role in its economic development. Consequently, despite the absence of diplomatic relations, many foreign countries' economic and political policies affect Taiwanese business. Major trade partners, particularly the United States, can significantly influence Taiwanese political and economic policy.

In the last three years, U.S. pressure has forced Taiwan's economy to become more liberal and international. These changes are evident in six areas: the appreciating NT dollar, a market steadily opening to U.S. commodities, an improving flow of capital, increased purchases of American equipment for major construction projects, reduced tariff rates and import hindrances, and a relaxation of controls over foreign exchange reserves.[9]

In the past, uncertainty about Taiwan's political prospects led foreign partners to avoid making contracts with or investing in Taiwan. That is no longer the case. Because of the recent political stability and economic progress Taiwan's GNP has grown rapidly, averaging approximately 7.9 percent per annum during the 1980s. During the same period, GDP grew at an annual average rate of 7.4 percent. During the 1970s, the GDP growth rate was even higher, averaging approximately 11 percent per annum. According to Clark, these figures indicate that Taiwan's growth rate has been one of the highest in the world.[10]

This growth has meant both stability and progress, with Taiwan's unemployment rate holding steadily at about 2.5 percent during the 1980s, and its annual inflation rate averaging 2.5 percent. Taiwan's increasing living standard is undoubtedly an important achievement for a developing country.

2. Governmental Influences

Because most Taiwan businesses are small or medium- sized, they lack the management systems needed to expand, capital needed to invest in research and development, and the resources, human and financial, to upgrade their operations. As a result, Taiwanese business is strongly dependent on the government. Like Communist countries, Taiwan's conservative government makes most economic and business decisions and controls almost all operations through various policies.

One is its currency policy and central banking system. Its currency is issued and managed by a state-owned bank, the Central Bank of China in Taipei, established in 1928. In addition to issuing the currency, its functions include: (1) establishing monetary control strategies; (2) financing commercial banks; (3) regulating the rediscount rate and other related rates; (4) regulating maximum interest rates paid on deposits and interest rates charged on bank loans; (5) regulating ratios and required deposit reserve amounts; (6) designating liquidity ratios for commercial banks; (7) regulating open market operations; (8) providing check clearing houses; (9) maintaining the International Monetary Reserves and stabilizing foreign currency exchange rates; and (10) handling Treasury affairs.[11] Obviously, the Central Bank of China controls all aspects of Taiwan's banking system.

For example, in January 1989, the Central Bank of China blocked the issuance of new shares in three mutual funds by refusing to authorize the necessary foreign-currency transfers. As a result of the bank's far-reaching control, all businesses operating in Taiwan must be concerned with its policies.

Another way the Taiwanese government influences business practices is through its legal system. Ironically, Taiwan's Corporation Law imposes more restrictions on large-sized corporations than on small or medium-sized enterprises. For example, a large corporation's accounting system, number of shares and stockholders, and its ability to obtain financial credit are rigidly regulated. These requirements are not as stringent for small businesses. However, Taiwan's tax laws, related regulations, and tax enforcement discourage small or medium-sized enterprises from expanding.[12] Nevertheless, by remaining small, these enterprises often gain advantages such as greater freedom of control from regulations and the ability, within legal bounds, to conceal profits and avoid taxes to a greater extent than large-scale enterprises. This is the reason Taiwanese businessmen prefer small-sized to large-scale businesses.

In addition to control through the banking and the legal systems, the Taiwanese government has another important policy affecting economic development -- investment incentives. Early government policies emphasized limiting imports and promoting exports. The government provided many incentives encouraging people to establish their own businesses. These have included relatively easy access to various financing sources, such as Cooperative Bank loans, Medium Business Bank loans, and assistance by the National Youth Commission.[13] Along with these policies, the government has provided a sound economic infrastructure to stimulate small and medium-sized enterprises.

Besides all of these policies, several basic manufacturing industries are government-owned. All of Taiwan's businesses are either privately-owned or government-owned. Much -- 78 percent -- is privately owned.[14] The government ownership of 22 percent of industry includes the country's basic manufacturing industries, such as sugar, petroleum, power production, communication, and transportation.[15] Although these government-owned industries create some problems in the business structure, the Taiwanese government still maintains control because of the threat of monopoly.

3. Cultural Influences

Because of fifty years of Japanese colonialism, Taiwan's culture represents a blend of Japanese and Chinese traditions, to which has been added the Western influence.[16] Among these influences, the predominant belief in Buddhism plays an important role in the work ethic. Old-style, conservative Buddhist society tends to view events as "the will of God." Such an atmosphere is reflected in business behavior.

Compared with other countries, people in the Taiwanese society generally show disproportionate respect to those holding titles, such as chairman of the board, president, or manager. This attitude encourages many people to aspire to be presidents or managers themselves. Also, in any family-run firm, non-family members are typically not fully trusted and are usually considered "outsiders." These "outsiders" can, at best, expect to be promoted only to the second-highest position. Once they learn all about a particular business, they often will open competing firms. These attitudes have limited the expansion of small-sized businesses into large-scale enterprises.

Taiwanese business behavior is considerably different from that in Western countries, although Taiwanese society is influenced by western style. Hofstede, a cross-cultural researcher, conducted a survey involving forty countries.[17] Differences between Taiwanese and American business behavior are revealed in his survey. These differences include the fact that Taiwanese managers maintain a greater distance between themselves and their subordinates than do American managers. Further, based upon their managers' opinions, Taiwanese subordinates will modify their views more readily. This means that Taiwanese employees prefer instructional rather than consultative decision making. This is considerably different from the American style.

In addition to the behavior mentioned above, Taiwanese people thrive on "the relationship." This attitude can also be reflected in business operations. "The relationship" includes establishing a good personal relationship with government or foreign partners. If a foreign trading partner understands this concept and makes an attempt to establish a favorable relationship, there is almost nothing the Taiwanese will not do for him. Similarly, if a Taiwanese businessman can establish a good relationship with the Taiwanese government, it is easy for his enterprise to get a bank loan or governmental assistance.

In the past, the threat of Communist China and the sense of uncertainty about Taiwan's political future have led Taiwan's enterprises to focus attention on short-term profits rather than longer-range plans.

Another obstacle is the fact that most Taiwanese businesses are small or medium-sized. Such companies can make decisions quickly and implement them equally fast. They can be very flexible, and this is to their advantage. For these reasons alone, it is not surprising that Taiwan's entrepreneurs have not wanted to expand their enterprises.

Although these businesses seem to be successful, they often encounter noticeable problems. These problems include the following: (1) an inability to provide sufficient collateral, the lack of a sound accounting system, and an insufficient expertise in capital planning; (2) a shortage of management expertise, and negligible consensus on suitable and simplified management systems; and (3) the possession of only limited knowledge and, in many cases, the inability to conduct independent research and development.[18] Most businesses in Taiwan have traditionally had to be adept at finding ways to survive in the domestic or international markets. They have their own methods of self-development. They do not want to change or even to expand.

However, today's businesses are facing a much more competitive domestic and international environment. Some Taiwanese businesses are spending more time expanding their expertise. Taiwanese businessmen are participating in various government and private consulting institution courses, which cover a wide range of modern enterprise management concepts and skills. They have also been involved in improving their companies' structures in order to become more "internationalized."

B. Accounting in Taiwan

The cultural and other influences mentioned above also have an important impact on Taiwan's accounting practices and systems. Because most of Taiwan's enterprises are small or medium-size, uniform accounting systems have not yet been established. Most enterprises do not have their own accountants, they do not record their accounting information in their financial statements, and they do not audit their own financial statements, even when they are available. The following section will discuss the two most important factors affecting accounting in Taiwan.

1. Influences on Accounting

The government has the most significant influence on accounting. This influence comes from three separate sources, but there is little coordination among them. In fact, the three sources regularly have conflicting approaches to the reporting of financial information.

The first source of government influence is the Corporation Law. This is administered by the Ministry of Economic Affairs.[19] The Corporation Law is applied to all business organizations in Taiwan. It has its roots in the Japanese Commercial Code, with modifications occasioned by Chinese cultural traditions. For example, the accounting systems of all Taiwanese companies are regulated under Sections 228 through 245 of the Corporation Law. These sections require that companies file financial statements. These statements must be audited and open to public inspection. The Law also states limitations on interest payments, dividends and appropriated retained earnings for all Taiwanese companies.

The second source of government influence is the Securities and Exchange Law. This is administered by the Securities and Exchange Commission of the Ministry of Finance. This law applies specifically to joint stock and limited-liability companies.[20] A company must file its financial statements with the Ministry of Finance and with any stock exchange on which it is listed.[21] The financial statements are available for public inspection at the Ministry and at the relevant exchanges. Thus, the functions and powers of the Ministry of Finance in relation to financial reporting are similar in many respects to those of the U.S. Securities and Exchange Commission.

The third source of government influence arises from tax laws and regulations. Enacted by China's Congress in 1943, they are a mixture of statutory provisions that have come from the United States, Germany, Japan, and Great Britain. Because of the lack of standardized financial accounting systems, most enterprises use these tax laws and regulations for financial accounting purposes. Their adoption results in a significant impact on financial reporting. This is so because, as in the United States, certain deductions for expenses and income deferrals are permitted only for tax purposes. Examples of these deductions and deferrals are depreciation and profit from installment sales. The Ministry of Finance, as the highest administrative organization of taxation, sets taxation policies, enforces tax laws, and oversees the levy and collection of taxes.[22]

In addition to government influences, several companies, especially multinational enterprises, are strongly affected by accounting developments outside Taiwan, particularly in the United States. Before June 1982, there were no generally accepted accounting standards in Taiwan. Most Taiwanese accountants adopted U.S. accounting standards for financial reporting purposes. This may help to explain why Taiwan has been slow in establishing its own definitive standards.

Additionally, the Taiwanese accounting profession has had nearly as much influence on financial reporting as has the government. The Taiwanese Institute of Certified Public Accountants (TICPA) was established to promote the Taiwanese Financial Accounting Standards, which will be discussed later in this chapter. Besides these, many companies have modified their financial reporting to conform with banking requirements for obtaining loans.

2. Organizations Involved in Standard-Setting

a. Securities and Exchange Commission (SEC)

Established in 1960, the Securities and Exchange Commission (SEC) is an agency of the Taiwanese government charged with the responsibility of supervising and regulating securities issued to the public or listed on the stock exchange. In 1968, the SEC issued "Guidelines for Corporate

Financial Reporting." This directive contained details regarding limitations in the area of financial reporting, including the types, format and elements of financial statements. In addition, the SEC is required to monitor annual audited financial statements and to review unqualified financial statements. Obviously, the SEC has made important contributions in the area of accounting education and investor protection.[23]

b. Financial Accounting Board (FAB)

Before 1981, there were neither professional accounting organizations nor a common set of accounting standards and practices in Taiwan. The accounting profession took steps to establish an accounting rule-making organization to develop Taiwan's own accounting theory structure and set of practices. As a result, the Financial Accounting Board (FAB) was set up by the TICPA. The FAB is composed of twenty-two committees and three advisors, who come from a variety of backgrounds. The members of the FAB include representatives from the accounting profession, banking, industry, government, and universities. Like the Financial Accounting Standards Board in the United States, the mission of the FAB is to set up and improve standards of financial accounting and reporting for the guidance and education of the public, which includes professional accountants, auditors, and other users of the financial information.[24]

Since July 1982, thirteen statements of Financial Accounting Standards have been issued.[25] In addition, the FAB has issued two interpretations.

Today, these accounting standards and interpretations are generally accepted and practiced. They are shown here.

Statement		Date of Issue
No. 1	Generally Accepted Accounting Principles	07/01/1982
No. 2	Accounting for Leases	10/01/1982
No. 3	Capitalization of Interest Cost	12/31/1982
No. 4	Reporting Changes in Financial Position	09/01/1983
No. 5	Accounting for Long-Term Investment in Stocks	04/01/1984
No. 6	Related Party Disclosures	06/15/1985
No. 7	Consolidated Financial Statements	12/31/1985
No. 8	Reporting Accounting Changes and Prior Period Adjustments	06/30/1986
No. 9	Accounting for Contingencies and Poststatement Events	09/15/1986
No.10	Valuation and Reporting of Inventories	05/20/1987
No.11	Accounting for Long-Term Contracts	07/20/1987
No.12	Accounting for Income Tax Allocation	12/28/1987
No.13	Accounting for Entity's Liquidation and Reorganization	06/01/1988

c. Accounting Research and Development Foundation (ARDF)

Because of the development and growth of business and economic activities, there is a greater necessity for accounting information relating to decision-making. Hence, there is an important need to develop Taiwan's own accounting conceptual framework. In April 1984, the TICPA raised over NT$8 million dollars to establish the Accounting Research and Development Foundation (ARDF), an organization similar to the Financial Accounting Foundation in the United States. Since ARDF's formation, the FAB has automatically become a division of the ARDF. ARDF's main objectives are: improving accounting education and technology, promoting nation-wide accounting standards, and helping businesses set up accounting systems. The ARDF has five primary functions: (1) to establish and improve financial accounting and reporting standards; (2) to establish and improve the guidelines on auditing practices; (3) to offer a set of training programs to the accounting profession regarding items (1) and (2); (4) to issue all the publications relating to standards and training; and (5) to research and develop other issues related to accounting theory and practices.[26]

This chapter describes Taiwan's business environment. This environment helps shape and define the nation's foreign exchange issues. Exchange rates, which are regulated by the Central Bank of China, are not always compatible with the interests of the business community. As a result, the foreign exchange rate affects the way in which Taiwanese companies deal with their imports and exports, as well as their other business and their accounting activities. These problems will be fully addressed in Chapter III.

CHAPTER III.

THE FOREIGN CURRENCY ISSUE

Multinational commerce begins with international trade of the export or import variety. Trading goods beyond the borders of Taiwan requires the use of foreign currency, not only in the receipt of payments from abroad for exports but also in order to utilize another currency to pay for the imports desired. Both transactions need measurement in two currencies, the local currency and the foreign currency. Foreign currency, of course, is a commodity that is traded on foreign exchange markets.[27] Under the floating exchange rate system, currency values fluctuate daily on the basis of supply and demand.[28]

The exchange rate between the NT dollar and the U.S. dollar is basically determined by the relative economic positions of each country. The relative economic positions are, in turn, a function of international trade, services, transportation, and investors' wishes. In addition, the intervention of the Central Bank of China in the interbank market, interest rates, social and political situations, and the relative purchasing power of Taiwan and the United States all have a great deal of influence on the exchange rate. Hence, the combination of international commerce and the floating exchange rate system creates several specific problems in conducting business in Taiwan. Following Kuo's viewpoint, which he mentioned at a conference he attended during early 1988 regarding foreign currency, two critical problems faced by Taiwanese companies are the accounting issue and the economic issue.[29] Each of these issues is defined below.

A. The Accounting Issue

Multinational companies face the peculiar problem of the accounting or the translation issue. This accounting or translation issue involves component financial statements and their interrelationship. The problem lies in the fact that financial statements are denominated in different currencies. The resulting question is how to select and justify a particular exchange rate for translating the financial statements of foreign subsidiaries for consolidation purposes.[30] The translation issue has had worldwide significance since fixed exchange rates were replaced by floating rates in 1973. In Taiwan, however, the translation issue has had significance only since September 1985. There is a variety of concerns faced by multinational corporate management relating to this issue.

1. Financial Reporting Concerns

One of the most important concerns is the adoption of uniform accounting or translation methods. Investment abroad is one strategy proposed by the Taiwanese government and many economists for solving the NT dollar appreciation problem. In following this strategy, however, it is essential that the financial reports of foreign subsidiaries accurately reflect the valuation of foreign currencies. In the translation process, all financial statements of foreign subsidiaries should be restated in terms of the reporting currency, i.e., NT dollars, by multiplying the foreign currency figures by the appropriate exchange rate.[31] Fluctuating exchange rates thus give rise to two major questions: (1) Which exchange rate should be used in translating foreign currency balances into the domestic currency? (2) How should translation gains and losses be accounted for?[32]

Floating currencies are part of the reality of doing business in an international economic environment. The measurement of translation value is a major factor of consolidated financial reporting. The six major translation methods that have been used during the past decade are the temporal, the current-noncurrent, the monetary-nonmonetary, the all-current, the U.S. Statement of Financial Accounting Standard (SFAS) No. 52, and the International Accounting Standard (IAS) No. 21. Financial executives of Taiwanese multinational companies need to determine which translation method is most suitable. This is so because the method selected can significantly affect the income or loss of subsidiaries, and consequently it has a profound effect on the decision-making process.

Taiwan differs from the United States in that there is no standard or statement to govern which translation method is to be used.[33] In the United States, on the other hand, accounting for foreign currency is governed by the requirements contained in SFAS No. 52, which partially adopts the all-current method. Further, the selection of an exchange rate to be used in the translation process is complicated by the fact that some host countries maintain multiple exchange rates. A nation's government may maintain official rates that differ from the market-determined rate, depending on the nature of the transaction.

The determination of how gains or losses from the translation process will be reported in the consolidated financial statements of a Taiwanese parent company is another important factor. Will these gains or losses be shown on the income statement as an expense or income item to the parent company, thus affecting the earnings per share and stockholders' equity? In the alternative, will they represent an adjustment account which is directly reflected in the company's stockholders' equity and which can be used to defer the translation gains and losses in the future? There are no specified requirements in Taiwan's accounting practice.[34] However, the Taiwanese SEC's ruling is that loss from the currency translation may be treated as an expense and shown on the income statement, and gain from the currency translation should be treated as an adjustment account and shown on the balance sheet.[35]

These two questions will be treated in more detail in chapter V.

2. Concerns Related to Translation

Translation presents an accounting problem because exchange rates are not fixed. In addition to the translation problem, there are other important concerns created by the instability of various exchange rates.

The first concerns the evaluation of a subsidiary's performance in a multinational enterprise. The foreign affiliate's records and accounts are initially reported in local currencies and must conform to local accounting principles, standards, and procedures. Subsequently, however, the parent company must consolidate and report all foreign affiliate accounts in its own currency and in conformance with a single set of accounting principles, standards, and procedures. The same currency and an identical set of accounting standards are generally necessary in order to employ forecasting and monitoring techniques and to compare the operating results of these various foreign subsidiaries.[36] Fluctuating exchange rates increase the number of translation possibilities. Currency gyrations also give rise to exchange gains and losses that complicate the evaluation of multinational operations.

The second problem involves tax considerations. Sections 29 and 98 of the Taiwanese Enforcement Rule of the Income Tax Law provide comprehensive statutory rules for the taxation of gains or losses resulting from fluctuating foreign currencies.[37] Developing a basic understanding of the tax ramifications of foreign subsidiary gains and losses is critical to decision making and the tax planning process. For instance, a translation gain subject to section 29 at the end of the tax year is treated as an adjustment account on the balance sheet at that time. This gain, however, is not taxable. Thus, the adjustment account is treated as tax-free. However, if this translation gain is used for capitalization, it is taxable.[38]

B. The Economic Issue

From 1984 to 1988, the United States has had annual trade deficits of more than US$100 billion. (see Appendix VI) It is beyond cavil that the United States cannot afford the continued incurrence of these trade deficits in the coming years. During the same period, Taiwan's trade surplus with the U.S. has averaged approximately US$10 billion annually. (see Appendix VI) From the viewpoint of a healthy worldwide economy, Taiwan, in the future, cannot continue to benefit from the trade surplus it has experienced with the United States. Fortunately, a rebalancing of world trade has already begun, due to the sharp decline in the value of the U.S. dollar. This decline reflects fundamental economic forces. In many Americans' minds, however, the U.S. dollar's value can be expected to continue to fall until it is low enough to achieve either a balance of payments or a trade surplus.[39] In the beginning of 1989, one

British bank forecast that the NT dollar will probably rise 15 percent against the U.S. dollar until 1991.[40]

One of several economic issues is the possibility that a firm's economic value will increase or decrease as a result of a change in the exchange rate. As mentioned before, Taiwan's economy is highly dependent on international trade. An unstable foreign exchange market increases the risk to Taiwanese companies that conduct business with foreign companies. Because the amount to be received or paid is affected by a change in the exchange rate, there is a direct economic impact on a company's operations. Obviously, currency fluctuations may not only destroy corporate financial profitability and long-term planning but also make planning a much more difficult task. The following section will fully address several economic problems that arise.

The most serious economic problem is the existence of inflationary pressures. The Central Bank of China is concerned with the possibility that a too rapid currency appreciation could undermine the competitive position of exporters. Consequently, since 1985, it has adopted a policy of allowing only small daily appreciation of the currency.[41]

Market participants regard this approach as excessively conservative and counterproductive. It has induced local citizens and foreigners alike to bring funds into Taiwan from abroad,[42] thus exacerbating an already difficult problem. The result is high liquidity and an increasing money supply. From 1986 to 1988, the monetary growth climbed 47.67, 38.25, and 25.23 percent, respectively.[43] It is obvious that the Central Bank's policy of limiting currency appreciation is not working as effectively as anticipated. The outcome is that real and personal property as well as stock and bond prices are increasing.[44]

During the same period, domestic inflation was held to approximately only 2.5 percent annually because of cheap imported raw materials and the Central Bank of China's measures to soak up excess liquidity. For example, the Central Bank of China has issued billions of dollars of securities to try to control the excess liquidity.[45] Even though the country has experienced modest increases in commodity prices, the excessive buildup of liquidity threatens to create a future outbreak of inflation and other economic distortions.

These circumstances will distort both the real economy and financial markets, and could hurt the personal living standards. Hence, the interrelationship of increasing commodity prices or inflation and a fluctuating exchange-rate is of utmost concern to the Taiwanese government and its people.[46] A low inflation rate, on the other hand, is probably the most important factor for ensuring Taiwan's economic stability and growth. Thus, as many Taiwanese economists insist, the Taiwanese government cannot just protect exporters but must also adopt affirmative policies to prevent inflation.[47]

Another important part of the economic issue is transaction risk. Transaction risk results when a domestic company imports or exports goods from or to a foreign company. The problem is that the invoice may be denominated in a foreign currency. Due to the lapse of time between the date of the transaction agreement and the date when payment is made, there is a strong likelihood that the exchange rate will change. This risk can severely complicate pricing decisions for a company's exports as well as require it to analyze more thoroughly the cost of goods it may need to import. Too, the interrelationship between departments within a company requires exceptional communication and cooperation in order to ensure that pricing decisions are made as timely as possible in view of fluctuating exchange rates.

Finally, there are other economic realities to be considered in operating a business abroad. The most important is the requirement of highly specialized knowledge.

The first problem is how to forecast exchange rate movements, including the forecasting of forward exchange rates and spot exchange rates, and the interrelationship between them. Various factors can have an influence on exchange rate movements. These factors include the following: (a) relative rates of inflation, (b) balance of payments statistics, (c) reserve position, (d) interest rate differentials, (e) trends in the spot rate, and (f) the forward rate.[48] Forecasting exchange rate movements not only affects long-term investment, cost and pricing strategies, and the manner in which payments will be made (i.e., what currency will be used for payments), but also has an effect on the terms of bank loans.

The second problem is how to design a forward contract, which is an agreement to exchange currencies at a specified future date for a specified rate, i.e., the forward rate. Rising exchange rates can destroy a company's exporting profitability; but, on the other hand, such changes will most likely enable a company to purchase imports more cheaply. What is important is how managers deal with the uncertainty of future payments or receipts, and how they measure the gains or losses in a forward currency market.

The third problem is how to hedge against fluctuations in foreign currency. Simply stated, risk management of multinational operations involves deciding between the purchase and the sale, between a foreign country and domestic market, between the current transaction and the future commitment, and whether it will be a cash deal, credit arrangement, or a forward exchange contract. All of these will be described in the next chapter.

CHAPTER IV.

FOREIGN EXCHANGE RISK MANAGEMENT

A multinational company is subject to an additional risk of doing business when changes in the values of its assets and liabilities are denominated in foreign currencies. Currently, managing this risk constitutes one of the most difficult and persistent problems for the financial managers of Taiwanese multinational companies. However, since currency movements can have substantial impacts on profitability, financial managers should give high priority to understanding fully such issues and establishing effective control programs.

The starting point for the formulation of a firm's foreign exchange risk management policy must necessarily an evaluation of what the firm has at risk. This risk may result from the fluctuations of foreign currencies and the concomitant variations in exchange rates that were discussed earlier. The major goal in foreign exchange risk management is to shelter corporate profits from the negative impact of such exchange rate fluctuations. A lesser goal is possibly to profit from foreign exchange-risk management. At a minimum, managing foreign exchange risks implies making as much profit as would be expected if the firm did not have to engage in foreign exchange transactions. The purpose of this chapter is to discuss the strategic choices facing Taiwanese multinational firms in the management of foreign exchange risk in today's international economic environment.

A. Governmental Strategies

Traditionally, most multinational firms, either domestic or foreign, have followed a passive strategy to neutralize the impact of foreign currency fluctuations.[49] They have relied on government policy to solve the problems involved with a floating exchange rate. Until now, government policies have played an important role for multinational enterprises worldwide. For example, the Japanese government increased domestic interest rates with the aim of raising the value of the Japanese yen in an attempt to forestall support for anti-Japanese protectionist legislation in the United States.

The Taiwanese government has recently adopted several measures in order to counteract these economic problems. These measures include the following: (1) speeding up the process of import liberalization, (2) diversifying export markets, (3) enlarging domestic demand, and (4) allowing private enterprises to invest abroad.[50]

1. Speeding up the Process of Import Liberalization

The Taiwanese government traditionally adopted many policies to protect its domestic manufacturers and exporters. However, in order to avoid the bottlenecks of international trade and to advance economically, the Taiwanese government has undertaken some liberal policies. These liberal policies include continuing gradually to lower tariffs and the elimination of non-tariff barriers in order to improve domestic market access to foreign goods and services. Since February 1988, when duties were revised, Taiwan has responded by lowering tariffs on over 4,500 import items, with many cuts averaging 50 percent.[51] The Taiwanese government has also removed non-tariff barriers, such as harbor construction fees, and relaxed limitations on foreign investments and trade in foreign services such as insurance, banking and retail.[52] Actually, import controls have been greatly eased.

2. Diversifying Export Markets

In order to minimize U.S. pressure stemming from Taiwan's heavy dependence on the U.S. market, the Taiwanese government has recently emphasized diversifying export markets, and further, has undertaken many policies to improve trade relations with other areas. For example, the Taiwanese government has initiated many trade exhibitions for her manufacturers and exporters to draw buyers from countries other than the United States. Also, the Taiwanese government is actively promoting economic and technical joint ventures with South American and Southeast Asian countries. Meanwhile, Taiwanese businessmen are making efforts to increase trade with European Economic Community countries, Canada and Japan. They have also considered the possibility of fostering transactions between Communist countries, including Mainland China and east European countries. Trade with Europe, previously of minor importance, has become a major focus of government trading policy. Thus, ties with both Western and Eastern Europe are increasing at a rapid pace.

3. Enlarging Domestic Demand

One of the strategies of reducing the pressures from the appreciating NT dollar is to increase imports while still maintaining exports.[53] The necessary requirement for increasing imports is to enlarge domestic demand. It is not easy to change the traditionally conservative Taiwanese consumer behavior and encourage them to spend more and save less. However, the Taiwanese government has taken steps to persuade its people to change their views and to encourage them to spend more money on imported products. In another move that should stimulate domestic consumption, government employees have received pay raises of about 10 percent during both 1987 and 1988. Likewise, the Taiwanese government has also increased its spending, not only because it has not yet suffered from a current account budget deficit, but also because the social infrastructure does not yet meet the requirements of a modern country. Thus, a "Buy-American" policy has been adopted by the Taiwanese government. At the same time, several local modernized economic construction plans have proceeded aggressively.

4. Allowing Private Enterprises to Invest Abroad

Whether private enterprises should be allowed to invest abroad or not has long been a subject of debate in Taiwan. The government has worried about the outflow of capital and the inability to control the value of its own currency. However, a few private enterprises have, in fact, engaged in direct foreign investment since 1970, in order to acquire access to foreign markets and maintain control over resources and materials. Today, the attitude of the Taiwanese government towards overseas investment has switched to a positive view. Foreign investment is considered to be a strategy for improving Taiwanese business and industrial enterprises, and for firmly maintaining formal diplomatic relations with other countries.[54] Therefore, certain incentives, such as special allowances and low-interest loans provided to investors, have been offered by the government.[55]

B. Strategies Adopted by Foreign or Domestic Companies

Since the early 1980s, many multinational firms have begun actively managing their foreign currency portfolios to minimize risks and maximize profits. Managerial strategies which have been adopted to lessen the problems of fluctuating foreign currencies include the following.

First, some parent companies hedge their exposed net foreign assets or liabilities by entering into receivables or payables transactions, or hedge their payables and receivables by buying and selling currency contracts for future delivery in the interbank forward market. For example, Du Pont, an American company, uses a simple strategy to lock in forward exchange rates each month. Even in 1987, the most volatile year for fluctuations in the exchange rate, Du Pont was still insignificantly affected by the floating exchange-rate.[56]

Second, other multinational firms use a foreign exchange options method for coping with today's highly volatile currencies. Foreign currency options provide the opportunity, but not the obligation, to buy or sell a foreign currency at a specified price within a specified time period.[57] This method serves managers by allowing them to hedge against contingent foreign exchange exposures. Hedging affords them the opportunity to take a position on the direction and uncertainty of exchange rate movements and may be used in portfolio management to allow them to construct their portfolios according to the specific risk return profile they desire.

A successful example is the Union Carbide Corporation. Union Carbide treats currency management as a profit skill. This skill is applied by concentrating all the foreign-currency assets and liabilities of the company's international operations. Then the company hedges a portion of these amounts with foreign currency options. In 1987, when major foreign currencies appreciated rapidly against the U.S. dollar, Union Carbide earned tens of millions of dollars in profits through this hedging policy.[58]

Third, in order to minimize risks, some companies diversify their international operations by investing and operating in countries whose currencies are less subject to fluctuation on the foreign exchange market. (This foreign investment strategy, as proposed by the Taiwanese government, is described in the preceding section.) For instance, in 1985, Huang Yung-sen, a Taiwanese businessman, believed that the glove industry he was operating would face some bottlenecks that would prevent his company from maintaining its competitive position in the international business environment. He moved his company to South Africa. As of today, his company has tripled in size, and he has been able to maintain annual gross profits of 15 percent or above.[59]

Fourth, some Taiwanese companies use the Japanese yen or the West German mark in their international contracts. Traditionally, almost all Taiwanese foreign trade contracts were written in terms of U.S. dollars.[60] Today, however, the NT dollar is not the only currency appreciating against the U.S. dollar. The Japanese yen and the West German mark have both risen even faster. (see Appendix II) This means that Taiwanese companies can sell to the United States some products that it would normally buy from Japan or West Germany.[61]

Fifth, a local-currency contract is considered one of the most successful policies in actively managing fluctuating currency risks. By using this strategy, businesses are neutrally affected by an appreciating local currency. At the same time, businesses can benefit from the importation of materials because of a rising local currency. Several West German and Japanese companies have adopted this policy to shelter risks from their appreciating currencies. Today, 40 percent of Japanese companies use the Japanese yen to define their foreign contracts, while 60 percent of the West German companies use the German mark to define their foreign contracts.[62]

Sixth, in order to minimize the potential for conflicting information between foreign subsidiaries, more and more companies have centralized their financing, marketing, and production decisions from a global viewpoint. Thus, most foreign currency dealings among foreign subsidiaries are channeled through their parent headquarters. As an example, R. J. Reynolds Industries has centralized its worldwide intercompany trading, borrowing, and hedging activities to turn exchange-rate risks to the company's advantage.[63]

Seventh, a number of businesses purchase broad-based insurance to cover risks which include the risk that a contract will not be completed, the risk that a buyer will not pay the seller, and the risk associated with fluctuations in foreign exchange rates.

Eighth, several enterprises strictly limit their business dealings in foreign currencies by using a straight barter system. These cross-border barter transactions are a direct response to exchange rate uncertainties in that they eliminate any form of exposure.

Ninth, most companies employ exchange experts to research and forecast exchange rate movements. They also are employed to compile information (especially through the use of computers) regarding various factors which tend to influence currency fluctuations, and to deal with hedging, options, forward contracts, etc. For example, Timothy O'Neill, vice president of foreign exchange for Goldman Sachs, helped design several currency hedging methods, most consisting of some combination of forward contracts and options.[64]

Finally, several Taiwanese economists have made additional recommendations. These recommendations include the promotion of domestic markets, upgrading business control skills, improvement of industrial structures, strengthening economic management, increasing productivity, and the reduction of production costs.[65]

CHAPTER V.

FINANCIAL REPORTING OF FOREIGN CURRENCY TRANSLATION

The last area is the complex topic of foreign currency translation. Today, foreign currency translation has assumed critical importance. International business activity has increased through growth in foreign trade and the proliferation of corporate multinational subsidiaries, both in number and in size. In addition, the international economic environment has also become more volatile. Debate over the translation process touches on many issues, but the various theoretical concerns can all be traced to a single problem: accounting for the effects of currency exchange rate fluctuations. As the name implies, these rates are measurements by which one currency may be converted into another. The primary purpose of this chapter is to present the general characteristics of foreign currency translation. Second, several methodologies of its financial reporting will be delineated.

A. The General Characteristics of Translation

Companies operating internationally use a variety of methods to express, in terms of their domestic currencies, the assets, liabilities, revenues, and expenses that are stated or have been quantified in a foreign currency. The primary purpose in reporting foreign currency translations is to produce meaningful and consistent consolidated financial statements. Companies with significant operations abroad cannot prepare consolidated financial statements unless their accounts as well as those of their subsidiaries are expressed in terms of identical currency. Thus, one cannot add Japanese yen, French francs, and the U.S. dollar and obtain meaningful results. Consequently, a unified currency framework is required, and this is typically the reporting currency of the parent company. The process of restating various foreign currency balances to single currency equivalents is called "translation." Additional reasons for foreign currency translations are (1) recording foreign currency transactions, (2) reporting international branch and subsidiary activities, and (3) reporting the results of independent operations abroad.[66]

Translation is an accounting process in which amounts measured in one scale are converted to amounts of another scale by applying the rules of transformation. However, translation is not synonymous with conversion. Conversion implies that one currency is changed into another currency, usually through the foreign currency section of the commercial bank with which a firm deals. Translation implies that one currency is expressed or restated in terms of another currency.[67]

The preceding definition of translation, however, does not imply any attempt to convert foreign currency items physically into reporting currency units of money either currently or in the future. Translation is regarded simply as a neutral restatement process designed to generate the foreign accounts in a different unit of measurement, i.e., the parent-company currency.[68]

In terms of economic objectives, the most significant aspect of the translation process is to attempt to assess and account for the future stream of earnings from the foreign subsidiary. This objective requires a translation strategy that will produce either an exchange gain or an exchange loss depending upon the exchange rate in effect at any point. Accordingly, a particular translation method should be chosen that will result in gains and losses being reported in such a way that they are compatible with the expected economic effect of a change in the exchange rate.[69]

In the United States, the Financial Accounting Standards Board (FASB), in 1975, defined the objective of translation as measuring and expressing the assets, liabilities, revenue, and expenses that are measured or denominated in foreign currency in U.S. dollars. However, in 1981, the U.S. FASB redefined the translation objective as follows:

1. Provide information that is generally compatible with the expected economic effects of a rate change on an enterprise's cash flows and equity.

2. Reflect in consolidated statements the financial results and relationships of the individual consolidated entities as measured in their functional currencies in conformity with U.S. generally accepted accounting principles.[70]

B. Translation Methodologies and Their Applications

Many variations in translation methods have been suggested and used by the accounting profession. All, however, have their genesis in one of four major historical translation methods: current-noncurrent, monetary-nonmonetary, temporal, and all-current method. Of the translation methods seriously proposed or implemented in the past decade, six appear to be worthy of careful examination. This examination includes the four historical methods and two of their applications -- the United States approach and the International Accounting Standards approach.

The methods to be evaluated are based on translation rates determined from currency exchange markets. Each method classifies the accounts to be translated in one of two categories: a "current rate" account or an "historical rates" account.[71]

Current rate accounts are translated on the balance sheet at the exchange rate in effect as of the date of the balance sheet. Exchange rate fluctuations therefore cause fluctuations in translated current rate account balances. Translation at historical rates requires that the currency be translated at the market rate in effect at the time the transaction was originally recorded. Exchange rate fluctuations have no effect on account balances translated at historical rates. Such balances are not subject, in the accounting sense, to exchange rate risk.

1. The Current-Noncurrent (CN) Method

The current-noncurrent method is the oldest translation approach. This method was recommended by Accounting Research Bulletin 51, and was used fairly extensively until the promulgation of SFAS No. 8. According to this method, the balance sheet classification of assets and liabilities determined the exchange rate that should be employed in translation. Current items are to be translated at the current exchange rate, while noncurrent items are to be translated at historical rates.

Revenue and expense items, except depreciation, depletion and amortization expense items, are translated at the average exchange rate for the accounting period. Depreciation, depletion, and amortization expenses are translated at the historical rate applied to the asset being evaluated. Any exchange gain is deferred while the exchange loss is applied against any deferred gain, and if there is no deferred gain, the loss is included in the current period statement.

Use of the current-noncurrent method, however, can be misleading. The classification of current or noncurrent in determining which exchange rate to use in the translation process is unrelated to the objective of translation. This classification of assets and liabilities using two or more distinct exchange rates can only reveal the solvency or insolvency of a company. It cannot show the true financial condition of a company. Overall, this method lacks a theoretical accounting background and does not meet translation objectives.

2. The Monetary-Nonmonetary (MN) Method

The monetary-nonmonetary method was recommended by Accounting Research Study 12. This method was used by many companies before SFAS No. 8 went into effect. It uses the monetary characteristics of assets and liabilities as the basis for selecting an appropriate exchange rate for translation. Assets and liabilities are considered monetary items if they are expressed in terms of a fixed number of currency units. Cash, accounts receivable, and accounts payable are examples of monetary items. Fixed assets, long-term investments, and inventories are considered to be nonmonetary items. According to this method, monetary items are translated at the current rate, while nonmonetary items are translated at historical rates. The translation of income statement items and the treatment of exchange gain or loss under this method are similar to those under the current-noncurrent method.

The monetary-nonmonetary method meets the evaluation criteria used here better than the current-noncurrent method. This classification between monetary and nonmonetary is reasonable, but not totally satisfactory within an accounting theory framework. However, translation is an accounting process of measurement but has no relationship with this classification. There is no real distinction in classification between current-noncurrent and monetary-nonmonetary.

3. The Temporal (TE) Method

The temporal method was first introduced by Account Research Study No. 12. The purpose of this method is to use translation as a measurement process which does not change the attribute of the item being measured but changes only the unit of measure. According to this method, the current rate should be used to translate all monetary items and those nonmonetary balance sheet items which are not reflected at their historical cost but are carried on a current value basis. When translating nonmonetary balance sheet items carried at historical cost, the appropriate historical rate should be used. For example, inventories recorded at cost in the foreign statements are translated at the exchange rate that existed when the asset was acquired. Inventories are recorded at current market value while a current exchange rate is used to translate the account on the balance sheet. Income statement items are translated in a manner similar to that under the current-noncurrent method. In substance, the method of U.S. SFAS No. 8 was based on this method.

The theoretical attractiveness of this method is that the branches and subsidiaries would be translated into the parent currency in such a way that the parent currency would be the single unit of measure. Also, the temporal method appears to avoid most of the limitations of the previous two translation methods.[72] Nevertheless, this method violates the going concern concept because it is not necessary to record all items in the same manner. This method is also self-contradictory in that it actually results in an inconsistent evaluation relationship between inventory and the cost of goods sold. Another major criticism relates to the disposition of gain or loss on long-term debt. This method requires that firms translate long-term debt at current rates. Many firms feel that because the foreign currency debt is generally being liquidated by foreign currency earnings, there is really no parent currency exposure.

4. The All-Current (AC) Method

The all-current method is the easiest to apply. In this method, all assets and liabilities are translated at the current exchange rate in effect on the balance sheet date. Only capitalization is not translated at the current rate.

This method is easier to use than the others because a firm does not have to keep track of various historical exchange rates. The all-current method results in translated statements that retain the same ratios and relationships that exist in the local currency. For example, because all accounts are translated at a single exchange rate under the all-current method, the ratio of net income to sales remains the same in the reporting currency as in the local currency.

This method is undeniably useful for the translation of financial statements based on current values or price-level adjusted accounting measures. This method is the simplest translation method in terms of computation and record keeping. However, there are several flaws involved with using this translation method.

The first problem is in the choice between the market exchange rate and the official exchange rate. Basically, a foreign exchange rate is determined by supply and demand. However, some countries are intervening in the exchange markets to limit currency movements. There should be a difference between the market exchange rate and the official exchange, which is determined by government. The problem is aggravated by the degree of fluctuation in currency values in a world of floating exchange rates.

A second problem which may arise from the use of the all-current method is the possibility of having extraordinary exchange gains and losses when the foreign currency is subject to strong fluctuation.

A third problem arises from the use of foreign currency rather than the parent currency as the unit of measurement. The parent firm may object to using the subsidiary's currency while the subsidiary may argue that its local currency allows it to observe in parent currency units the same relationships seen in the historical local currency. The situation is basically a plus from the subsidiary's point of view and a minus from the parent's.

Finally, the all-current method may be considered a partial departure from the cost principle. In effect, it becomes a revaluation of assets expressed in foreign currencies while those assets expressed in local currencies are kept at cost.[73]

EXHIBIT

COMPARISON OF FOUR HISTORICAL METHODS' RATES USED TO TRANSLATE ASSETS AND LIABILITIES

Balance Sheet Accounts	CN	MN	TE	AC
Cash	c	c	c	c
Marketable securities				
at cost	c	h	h	c
at market price	c	h	c	c
Accounts receivable	c	c	c	c
Notes receivable	c	c	c	c
Inventories				
at cost	c	h	h	c
at market	c	h	c	c
Prepaid expense	c	h	h	c
Property, plant & equipment	h	h	h	c
Accumulated depreciation	h	h	h	c
Other intangible assets	h	h	h	c
Accounts and notes payable	c	c	c	c
Bonds payable	h	c	c	c
Other long term debt	h	c	c	c
Common stock	h	h	h	h
Paid-in surplus	h	h	h	h
Retained earning	amount used to balance the balance sheet			

Note: Exchange rate used: h = historical exchange rate;
c = current exchange rate.

5. The U.S. Approach

In 1975, the U.S. Financial Accounting Standards Board (FASB) issued the Statement of Financial Accounting Standard No. 8 which is based on the temporal method, except that translation gains and losses are recognized immediately in the income statement. In 1981, however, the FASB released a new statement regarding "foreign currency translation." From that time to the present, accounting for foreign currency in the United States. has been governed by the requirements contained in SFAS No. 52. This statement partially adopts the all-current method, except that translation gains and losses are not included in the income statement. They are shown as adjustments under stockholders' equity. Thus, SFAS No. 52 provides for the straightforward application of the all-current method.

SFAS No. 52 calls for the use of a "functional currency" in determining translation gains or losses. The functional currency can be either the U.S. dollar, the local currency of the subsidiary, or the foreign currency of another country. Therefore, the approach of the U.S. SFAS No. 52 can also be named the functional currency approach. "Functional currency" is defined as follows:

> An entity's functional currency is the currency of the primary economic environment in which the entity operates; normally, that is the currency of the environment in which an entity primarily generates and expends cash.[74]

a. Critique of SFAS No. 52

Because the U.S. accounting framework plays such an important role in the Taiwanese accounting profession, the author in particular has fully and carefully examined the requirements of SFAS No. 52. First, SFAS No. 52 allows for differences in foreign operations by adopting the functional currency approach which matches the method of translation to the situation. For example, the all-current method of translation is designated where the foreign currency is the functional currency (except where foreign operations are operating in highly inflationary environments). The temporal method of translation is designated where the reporting currency (United States dollar) is the functional currency. The temporal method of translation is also designated where the foreign entity is operating in a highly inflationary environment (defined as a three-year cumulative inflation rate of approximately 100 percent).[75]

Second, the adoption of the all-current method in SFAS No. 52 resolves several problems that existed under SFAS No. 8. They include the problem of economically incompatible results, the problem of operating margin distortions, and the problem of earnings volatility distortions (by recording translation adjustments directly to stockholders' equity).[76]

Third, SFAS No. 52 helps to strengthen the U.S. dollar and aids in slowing the rate of inflation in the United States by encouraging local currency financing (borrowing) and, thus, slowing the flow of the United States dollar overseas.

Finally, the U.S. FASB's adoption of the all-current method paves the way for standardizing foreign currency translation accounting among multinational enterprises worldwide.

Despite these advantages, there are a number of arguments which may be made against using this approach. First, in order for SFAS No. 52 to work, businesses must select what is called a "functional currency." Hence, the most important problem faced by managers in the decision-making process is the difficulty encountered in selecting which "functional currency" to use and then measuring the economic effect of that "functional currency" on the particular business involved. SFAS No. 52 provides six indicators for management to use in selecting the functional currency. These determinants are (1) sales market, (2) cash flow, (3) intercompany transactions and arrangements, (4) sales prices, (5) expenses, and (6) financing arrangements.[77] However, managerial judgment remains the most important factor in determining the functional currency for financial reporting purposes.

Second, SFAS No. 52 allows the accumulated gain or loss on net assets to be shown under stockholders' equity as a fluctuating adjustment account. However, this adjustment account for translation gains or losses has no physical property.[78] It has no economic meaning. The absence of meaning for this account can lead to confusion for users of the financial statements and raise questions about its use by managers in their financial planning.

Third, use of SFAS No. 52 has increased user difficulty by expanding the acceptable alternatives and complicating the translation process. Comparison of business performance between subsidiaries and the parent company and among each other is made more difficult by using this approach. Also, the users of financial statements may be confused as to how the translation numbers have been derived.

Fourth, SFAS No. 52 does not offer a clear and systematic theoretical explanation as to why different forward contracts should be accounted for differently or why forward contracts should be formally recorded in the accounts at all.[79]

Fifth, SFAS No. 52 has adopted objectives and methods which are at variance with fundamental accounting concepts. These include the distortion of the meaning of book value and the violation of the "clean surplus" doctrine.

Sixth, SFAS No. 52 incorrectly assumes that consolidated results measured in functional currencies rather than dollars are more useful in assisting U.S. investors and creditors in assessing future cash flow. Also, SFAS No. 52 does not provide the information needed for projecting future dollar cash flows as far as projecting the results of operations in terms of the U.S. dollar.[80]

Seventh, by using SFAS No. 52 managers, most likely will be faced with the problem of computing plant valuation and depreciation expense. Plant valuation is translated at the current exchange rate, while depreciation expense is translated at the average exchange rate for one accounting period. The floating exchange rate causes the accounting for depreciation expense, viewed from the domestic country, to be difficult to ascertain from one accounting period to the next. Also, the different translation exchange rates make it impossible for the accounting for plant valuation and accumulated depreciation to be comparable to the accounting for depreciation expense.[81]

Finally, SFAS No. 52 may not be suitable for reporting the continuous appreciation or depreciation of foreign currencies. Thus, the current exchange rate and the adjustment account are not necessarily suitable in an environment where foreign currencies are continuously fluctuating. SFAS No. 52 does not result in similar accounting for similar circumstances in certain instances.

6. The International Accounting Standards Committee Approach

Founded in 1973, the International Accounting Standards Committee (IASC) has been given the responsibility "of formulating and publishing in the public interest, basic standards to be observed in the presentation of audited accounts and financial statements and to promote their worldwide acceptance and observance."[82] IASC is at present comprised of 13 members. Those members include Australia, Canada, France, Germany (Federal Republic), Italy, Japan, Mexico, The Netherlands, Nigeria, South Africa, Taiwan, United Kingdom, and the United States.[83] However, there is no international enforcement agency extant to ensure compliance with its standards. This is of serious concern to the committee. Another problem is the lack of a theoretical accounting framework within the International Accounting Standards established by the committee.

Given the problems enunciated above, it is not surprising that the IASC has had difficulties preparing international accounting standards on some special topics. Generally speaking, the accounting practices adopted in the United States seem to have had a considerable influence on the direction taken in the international accounting standard-setting process. In July 1983 the IASC first addressed the subject of translation. The standards for translation released by the IASC followed by two years the publication of the U.S. FASB on the same topic. IASC's publication tracked closely with the earlier standard for translation promulgated by U.S. FASB. The IASC publication, IAS No. 21, was entitled "Accounting for the effects of changes in foreign exchange rates." It is clear that the IAS No. 21 is basically a reprint of U.S. SFAS No. 52.

7. Other Nations' Approaches

In addition to both the U.S. and IASC approach, the author has examined methods adopted by several other countries. Historically, British accountants have had mixed opinions as to which translation method should be used. Hence, the British Accounting Standards Committee (ASC) was in a very difficult position. This resulted in a 1978 survey on accounting for exchange rate fluctuations. Out of the 267 British companies surveyed, 251 used the all-current method.[84] Based upon the survey findings and the lead taken by the U.S. FASB a few years later, the British ASC, in May 1983, issued the Statement of Standard Accounting Practices (SSAP) No. 20 which, in relation to the translation of assets and liabilities, is virtually similar to the U.S. SFAS No. 52. It specifies the all-current method for most situations.

On the European continent accounting for exchange rate fluctuations is even more confused than in Britain. In many countries it has been quite common and perfectly legal for groups not to publish consolidated accounts. In fact, this has been the situation in Italy as late as 1985. Most French companies use the all-current method with regard to balance sheet reporting while average exchange rates are reported on the income statement.[85] In the Netherlands, the Civil Code requires that companies explain the bases for the translation of amounts expressed in foreign currencies, with disclosure of how translation and exchange differences are reported.

As is evident from these examples, European accounting practice in the area of translation is not uniform. Thus, in most of Europe, the choice of translation method is left up to the company. Europe's diversified accounting practices were sharply revealed in Graham's 1982 survey, which was researched from 199 European multinational companies. He found that most companies preferred to use the current rate in the translation process. His study further revealed that a minority of companies adopted an historical rate approach.[86]

The Canadian position on foreign currency translation is expressed in Section 1650 of the Accounting Standards Committee Handbook. Canadians do not use the term functional currency, but instead classify foreign operations as either "integrated" or "self-sustaining." Whether a foreign operation is classified as integrated or self-sustaining depends on the exposure of the reporting firm to exchange rate changes as determined by the economic facts and circumstances. Factors taken into consideration include basically the same indicators as those used in SFAS No. 52 previously described.[87]

Japan, like the United States, declares that exchange gains or losses arising in the translation of a foreign subsidiary's financial statements should be described as "foreign currency translation adjustments" and disclosed as an asset or a liability in the balance sheet. Some Japanese groups use the currency translation methods prescribed in U.K. SSAP No. 20 or in U.S. SFAS No. 52.[88]

8. Accounting Practices in Taiwan

Before discussing the Taiwanese method of accounting for exchange rate fluctuations, it is important to point out the Taiwanese financial reporting objectives. These are: (1) providing information that can assist users, such as investors and creditors, in making rational investment, credit, and similar decisions; (2) providing information that can aid users in assessing the amounts, timing, and uncertainty of their investment or credit; (3) providing information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events and circumstances that change resources and claims to those resources; (4) presenting business performance and profitability; (5) presenting information regarding an entity's liquidity and solvency; (6) providing information that can be used to assess the utilization of resources; and (7) explaining and interpreting the provided financial information so it is comprehensible to users.[89]

As mentioned previously, the Taiwanese accounting profession is significantly affected by U.S. accounting theory. Thus, prior to 1982, most Taiwanese accountants adopted the temporal method as promulgated by U.S. SFAS No. 8.[90] After SFAS No. 52 was issued, some Taiwanese accountants switched to the all-current method in order to keep pace with their American counterparts. The differential treatments in financial reporting can be confusing for the users of financial statements.

Taiwanese companies are faced with the dilemma of which translation method best suits their needs. This dilemma is of utmost importance to today's Taiwanese businessmen. The fact that only half Taiwanese businesses involved in international arena have adopted the translation method enunciated in U.S. SFAS No. 52 leaves the remaining firms subject to the vagaries of currency rate fluctuations. The 50 percent of Taiwanese firms that have not adopted the U.S. approach report exchange gains or losses on the profit and loss account. It is apparent that the U.S. approach to the treatment of exchange gains and losses has yet to meet with widespread acceptance in Taiwan.

Therefore, defining the most advantageous translation method for the future is the most important work facing the Taiwanese Financial Accounting Board. In light of the previous discussion, it appears that an entirely new translation method may need to be developed to deal with the problem of floating foreign currencies. The aim of this new method should necessarily be to obtain realistic measures which can provide meaningful information to financial statement users.

CHAPTER VI

SUMMARY AND CONCLUSION

When a firm enters the international market, floating foreign currencies can significantly influence business. The preceding chapters described the variety of international Taiwanese business operations. A Taiwanese company may also be involved in foreign activities through the operation of a foreign branch or subsidiary. Thus, one of the most important managerial problems facing Taiwanese firms that desire to operate internationally is the problem of foreign currency and foreign currency translation.

This paper has mentioned both economic and accounting concerns, including the use of the U.S. SFAS No. 52 or IAS No. 21 as accounting tools, for managers involved with the foreign currency issue. It has also listed several governmental policies, which have been proposed and in some cases adopted. Also included are several managerial strategies which have been employed by some local and foreign multinational companies in order to help Taiwanese multinational firms deal with the foreign currency issue and to reduce their exposure to economic risks. Also described are several accounting methodologies used in the translation process. If a foreign entity maintains its books in a foreign currency, its accounts must be translated into the reporting currency so that the accounts of the Taiwanese parent company and its foreign entity are measured in a common currency before the accounts are consolidated, or the entity method of accounting is applied. The concepts underlying the translation of the accounts of a foreign entity have been fully discussed in the chapter V.

Under pressure from the United States, the NT dollar value has been continuously rising since September 1985. In the author's opinion, this increasing value of the NT dollar is a major concern for Taiwanese multinational companies. As indicated herein, several strategies are available to the managers of multinational firms to lessen the risks associated with floating foreign currencies. From the author's viewpoint, foreign investment is the recommended strategy for Taiwanese companies wishing to avoid the rising NT dollar. Thus, more Taiwanese companies should consider conducting business abroad and becoming multinational companies in the coming years.

As more Taiwanese companies become multinational in scope, the selection of an appropriate accounting method to deal with differing currencies and exchange rates becomes all the more important. Each nation's accounting systems reflect the needs of its environment. Because of cultural, historical, and other differences in political and economic systems, these reporting needs differ from country to country.[91] Taiwan's accounting systems must reflect its unique cultural and economic environment.

Within each nation, accounting methods have changed due to economic conditions, social and political forces and requirements, and statutory and government regulations. In the United States, the SFAS No. 52 translation method, while preferable to the four historical methods described above, may not be suitable for translating the declining United States dollar in the future.

This will have an impact not only in the United States, but also in Taiwan. If this method is no longer used by U.S. companies, it may be unavailable for Taiwanese use. On the other hand, as a member of the IASC, the Taiwanese accounting profession should obey the requirements of IAS No.21. However, IAS No. 21 seems to have been copied from U.S. SFAS No. 52. IAS No. 21 covers the same problems dealt with in U.S. SFAS No. 52. In this circumstance, the value of accounting information is quite often lost if an inappropriate translation method has been used.

The determination of the available translation method is the most important issue facing existing multinational Taiwanese firms. Here are some recommendations in light of the discussion in preceding chapters: A new translation method can adopt the requirements either from the Taiwanese tax laws and regulations or from the U.S. SFAS No. 52, but either must be amended to deal with the problem of floating foreign currencies. The adoption of the Taiwanese tax laws and regulations is due to the influence of taxation on the Taiwanese accounting practices. Alternatively, using U.S. SFAS No. 52 meets the needs of the political and economic relations with the United States. Either one of these recommendations can be implemented to obtain useful and meaningful information for financial statement users in Taiwan.

ENDNOTES

1. Encyclopedia America, 1984, V.26, (Danbury, Connecticut: Grolier International Inc., 1984), p.232.

2. Cal Clark, "Economic Development in Taiwan: A Model of a Political Economy." Journal of Asian and African Studies (1-2, 1987):1.

3. Free China Review, "Partners Not Enemies." Free China Review (April, 1989):1.

4. Capital is similar to capitalization in U.S. financial Statement.

5. The Economist, "Taiwan: Survey." The Economist (March 5, 1988):S11.

6. Free China Review, "Background To The ROC 'Miracle'." Free China Review (April 1989):22.

7. "Taiwanese Investment in South Asian," International Daily News, 1 June 1989, p.14.

8. Joseph A. Martellaro, "United States-Taiwan Trade Relations and The Trade Deficit." Business Economics (July 1987):29.

9. Free China Review, "Partners Not Enemies." Free China Review (April 1989):1.

10. Clark, op. cit., p.3.

11. Chung-Hsiung Lin, Money and Banking, (Taipei, Taiwan: Jih-Sun Press Inc., 1988), p.368.

12. Cecilia Chang, "Everyone Wants To Be the 'Boss'." Free China Review (November 1988):11.

13. Ibid, p.12.

14. Collier's Encyclopedia, V.22, (New York: Macmillan Educational Company, 1988), p.41.

15. Ibid.

16. Ibid, p.42.

17. Geert Hofstede, *Culture's Consequences: International Differences in Work-Related Values*, (Beverly Hills, CA: Sage Publishions, 1980), Ch.3-6.

18. Hui-Lin Wu, "A Future For Small & Medium Enterprises?" *Free China Review* (November 1988):8.

19. The Section 5 of the Corporation Law.

20. The Section 3 of the Securities and Exchange Law.

21. The Section 36 and 63 of the Securities and Exchange Law.

22. Ti-Ying Cheng, "General Description of Taxation in the Republic of China." *Finance Research* (May 1, 1988):31.

23. Ting-Wong Cheng, *Intermediate Accounting*, (Taipei, Taiwan: Yi-Cheng Stationery & Press, Inc., 1984), p.41.

24. Ibid, pp.41-42.

25. Although the 14th statement was released on December 10, 1988, the information regarding this statement is not presently available.

26. Cheng, op. cit., p.42.

27. James G. S. Yang, "Managing Multinational Exchange Risks." *Management Accounting* (February 1986):47.

28. Lin, op. cit., p.490.

29. Lee-Jan Ju, "Conference: How to Identify, and Analyze the Risks from A Fluctuating Foreign Currency?" *Accounting Research Monthly* (August 10, 1988):8-9.

30. Jeffrey S. Arpan, and Lee H. Radebaugh, *International Accounting and Multinational Enterprises*, (New York, NY: John Wiley & Sons, Inc., 1985), p.126.

31. Ibid, pp.126-127.

32. Frederick D. S. Choi & Gerhard G. Mueller, *International Accounting*, (Englewood Cliffs, NJ: Prentice-Hall, Inc., 1984), p.114.

33. Ju, op. cit., p.9.

34. Ibid.

35. Ibid.

36. Ahmad Hosseini and Raj Aggarwal, "Evaluating Foreign Affiliates: The Impact of Alternative Foreign Currency Translation Methods." The International Journal of Accounting (Fall 1983):67-78.

37. Sections 29 and 98 of the Enforcement Rule of Income Tax Law.

38. Section 29 of the Enforcement Rule of The Income Tax Law.

39. Martin Feldstein, "Correcting The Trade Deficit." Foreign Affairs (Spring 1987):794.

40. "Exchange-Rate Movements Forecasted by A British Bank," International Daily News, 9 May 1989, p.12.

41. "Problems with the Liberalization of Foreign Currencies," Economic Daily News, 3 May 1989, p.2.

42. Ibid.

43. The Republic of China, Executive Yuan, Council for Economic Planning and Development, Industry of Free China, March 1989, Table 1, p.43.

44. "Don't Let the New Taiwan Dollar Be a Weak Currency," International Daily News, 2 April 1989, p.5.

45. Norman Peagam, "Taiwan: Island of Ingenuity." Euromoney (May 1987):57.

46. "Problems between Commodity Prices and Exchange Rates," Economic Daily News, 7 May 1989, p.2.

47. "Don's Let the New Taiwan Dollar Be a Weak Currency," op. cit.

48. Arpan and Radebaugh, op. cit., p.95-8.

49. Leah Nathans, "Watch the Bouncing Buck." Business Month (March 1988):70.

50. Tzong-Shian Yu, "Complexities Compounded." Free China Review (October 1988):26-9.

51. Liane McAllister, "Taiwan Rises to Economic Challenges." Gift & Decorative Accessories (June 1988):52.

52. Ibid, p.344.

53. "Enlarging the Domestic Demand Can Reduce the Pressure from the Appreciating New Taiwan Dollar," International Daily News, 15 April 1989, p.15.

54. Che-Hung Chen, "Taiwan's Foreign Direct Investment." Journal of World Trade Law (November-December 1986):647.

55. "The Incentives of Investing in The Dominican Republic Provided by The Taiwanese Government," International Daily News, 17 April 1989, p.6.

56. Nathans, op. cit.

57. David E., Miller, "Foreign Exchange Options." Cashflow (October 1985):23.

58. Nathans, op. cit.

59. Accounting Research Monthly, "Several Considerations on Investing Abroad." Accounting Research Monthly (November 1, 1987):10.

60. "Is the New Taiwan Dollar Really a Hard Currency?" Economic Daily News, 6 May 1989, p.2.

61. The Economist, op. cit., p.12.

62. "Is the New Taiwan Dollar Really a Hard Currency?" op. cit.

63. Christopher Power, "RJR's Foreign Coup." Forbes (September 12, 1983):226.

64. Jon Stein, "How International Funds Hedge Their Currency Exposure." Futures (May 1988):40.

65. Kun-Yi Li, "Ten Strategies to Avoid the Risks of Foreign Exchange." Accounting Research Monthly (August 10, 1988):16.

66. Choi and Mueller, op. cit., p.110.

67. Arpan and Radebaugh, op. cit., p.125.

68. Istemi S. Demirag, "A Review of the Objectives of Foreign Currency Translation." The International Journal of Accounting (Spring 1987):73.

69. Ibid, p.79.

70. U.S., Financial Accounting Standards Board, Statement of Financial Accounting Standard No. 52: Foreign Currency Translation, (Stamford, CT: FASB, 1981), p.3.

71. Jon R. Nance and Roger A. Roemmich, "Foreign Currency Translation: An Evaluation." The International Journal of Accounting (Spring 1983):43.

72. Ahmed Belkaovi, International Accounting: Issues and Solutions, (Westport, Connecticut: Greenwood Press, Inc., 1985), p.95.

73. Ibid, pp.94-95.

74. U.S. SFAS No. 52, op. cit., p.3, par.77.

75. Denise M. Guithues, Innovative Reporting in Foreign Currency Translation, (Ann Arbor, MI: UMI Research Press, 1986), p.70.

76. Ibid.

77. U.S. SFAS No. 52, op. cit., pp.26-27.

78. Nance and Roemmich, op. cit., p.46.

79. M. Ali Fekrat, "Accounting for Forward Exchange Contracts." The International Journal of Accounting (Spring 1984):84.

80. Guithus, op. cit., p.71.

81. Nance and Roemmich, op. cit., p.45-46.

82. S. M. McKinnon and Paul Janell, "The International Accounting Standards Committee: A Performance Evaluation." The International Journal of Accounting (Spring 1984):20.

83. Christopher Nobes and Robert Parker, Comparative International Accounting, (New York, NY: St. Martin's Press Inc., 1985), p.334.

84. Ibid, p.285.

85. Ibid, p.91.

86. Ibid, p.286.

87. Choi and Mueller, op. cit., p.109.

88. Nobes and Parker, op. cit., p.167.

89. R. O. C., Financial Accounting Board, Statement of Financial Accounting Standard No. 1: Generally Accepted Accounting Principles, (Taipei, Taiwan: FAB, 1982), p.1.

90. Choi and Mueller, op. cit., p.162.

91. James A. Schweikart, "We Must End Consolidation of Foreign Subsidiaries." Management Accounting (August 1981), p.15.

APPENDIX I

TAIWAN'S TRADE STRUCTURE (1987)

Country of Area	Value (US$000)	% of Country
Major Export Partner:		
U.S.A.	23,636,766	44.15%
Japan	6,962,076	13.00%
Hong Kong	4,112,662	7.68%
Germany, West	1,986,840	3.71%
Canada	1,558,866	2.91%
United Kingdom	1,536,395	2.87%
Singapore	1,348,840	2.52%
Australia	1,100,845	2.06%
Netherlands	1,087,449	2.03%
Saudi Arabia	703,471	1.31%
Others	9,503,690	17.75%
Major Import Partner:		
Japan	11,840,532	33.87%
U.S.A.	7,629,477	21.83%
Germany, West	1,633,500	4.67%
Saudi Arabia	1,075,312	3.08%
Australia	999,919	2.86%
United Kingdom	789,181	2.26%
Hong Kong	753,780	2.16%
Kuwait	730,154	2.09%
Malaysia	729,046	2.09%
Canada	651,745	1.86%
Others	8,124,593	23.24%

Source:

R.O.C., Executive Yuan, Directorate-General of Budget, Accounting & Statistics, Statistical Yearbook of the Republic Of China, 1988 pp.371-374.

APPENDIX II

FOREIGN EXCHANGE RATES IN SELECTED COUNTRIES (PER US $)

Unit: Per U.S. Dollar

	Taiwan: NT Dollar		Germany: Mark	Japan: Yen
Mo/Dy/Yr	Buying Rates	Selling Rates	Mid-point Rate	Mid-point Rate
12/31/61 --	40.00	40.10		
12/31/71	40.00	40.10		
12/31/72	40.00	40.10		
12/31/73	37.90	38.10		
12/31/74	37.95	38.05		
12/31/75	37.95	38.05		
12/31/76	37.95	38.05		
12/31/77	37.95	38.05		
12/31/78	35.95	36.05		
12/31/79	35.98	36.08	1.731	239.7
12/31/80	35.96	36.06	1.959	203.0
12/31/81	37.79	37.89	2.255	219.9
12/31/82	39.86	39.96	2.376	235.0
12/31/83	40.22	40.32	2.724	232.2
12/31/84	39.42	39.52	3.148	251.1
12/31/85	39.80	39.90	2.461	200.5
12/31/86	35.45	35.55	1.941	159.1
12/31/87	28.50	28.60	1.581	123.5
12/31/88	28.12	28.22	1.786	125.6

Sources:

1. R.O.C., Executive Yuan, Council for Economic Planning & Development, Taiwan Statistical Data Book, June 1988, p.199.
2. Central Daily News, (January 1, 1989), p.8.
3. R.O.C., Executive Yuan, Council for Economic Planning and Development, Industry of Free China, March 1989, pp.198-199.

APPENDIX III

STATISTICS ON APPROVED OUTWARD INVESTMENT BY AREA

Unit: Case(s)

Year	Thai-Land	Malay-sia	Singa-pore	Phili-ppines	Indo-nesia	USA	Others	Total
1959-1979	23	18	15	8	10	15	47	136
1980	--	--	4	--	--	8	5	17
1981	--	--	1	--	--	5	4	10
1982	--	--	1	--	1	2	--	4
1983	2	--	--	1	--	2	2	7
1984	1	1	1	--	--	13	6	22
1985	--	--	1	--	1	15	6	23
1986	3	--	3	1	--	16	9	32
1987	5	5	--	3	--	21	11	45
1988	15	5	3	7	3	42	34	109
1989 1-3	2	--	--	2	--	10	8	22
Total	51	29	29	22	15	149	132	427

Source:

R.O.C., Ministry of Affairs, Investment Commission, Statistics on Overseas Chinese & Foreign Investment, Technical Cooperation, Outward Investment, and Outward Technical Cooperation, The Republic of China, March 1989, p.28.

APPENDIX IV

NUMBERS OF FIRMS AND RATIOS OF SMALL AND MEDIUM ENTERPRISES

(Unit: number, %)

Year		Industry: Manufacturing	Industry: Commerce	Industry: Other	**Total**
1961	Number	51,389	91,389	36,138	**178,916**
	Ratio	99.7	99.6	99.5	**99.6**
1966	Number	26,938	123,979	63,668	**214,585**
	Ratio	97.2	99.9	96.7	**98.6**
1971	Number	40,739	161,734	71,889	**274,362**
	Ratio	95.4	99.9	96.5	**98.3**
1976	Number	68,616	264,005	85,517	**418,138**
	Ratio	98.7	99.7	97.6	**99.1**
1981	Number	90,580	314,442	103,762	**508,784**
	Ratio	98.9	99.7	97.5	**99.1**
1984	Number	120,981	442,377	156,082	**719,440**
	Ratio	98.8	98.4	97.6	**98.3**
1985	Number	119,073	445,587	151,564	**716,224**
	Ratio	98.8	98.5	98.3	**98.5**

Source:

Wu Hui-Lin, "A Future For Small & Medium Enterprises?" Free China Review (November 1988):7.

APPENDIX V

TAIWAN'S EXTERNAL TRADE INDICATORS

	Ratio of Export to GDP (%)	Trade Surplus (or Deficit) (US000,000)	Ratio of Trade Sruplus (Deficit) to GDP (%)
1968	18.6	-114	(3)
1969	21.3	-163	0
1970	26.1	-43	0
1971	31.3	216	2
1972	37.8	475	6
1973	41.6	691	6
1974	38.9	-1,327	(8)
1975	34.2	-643	(4)
1976	43.8	567	2
1977	42.9	850	5
1978	47.2	1,660	7
1979	48.4	1,330	1
1980	47.8	77	(1)
1981	46.8	1,412	2
1982	45.8	3,316	5
1983	48.5	4,836	9
1984	52.6	8,497	12
1985	51.1	10,621	14
1986	54.8	15,625	21
1987	55.0	18,581	18

Source:

R.O.C., Executive Yuan, Directorate-General of Budget, Accounting, & Statistics, Statistical Yearbook of the Republic Of China, 1988, pp.90-91, & 369.

APPPENDIX VI

THE TRADE RELATIONSHIP BETWEEN THE UNITED STATES AND TAIWAN

(BILLION OF THE US DOLLAR)

	U.S. Trade Surplus or Trade Deficit	Taiwan's Trade Surplus with The U.S.
1970	3.2	0.20
1971	-1.5	0.45
1972	-5.7	0.71
1973	2.4	0.72
1974	-5.1	0.36
1975	10.4	0.17
1976	-6.7	1.24
1977	-27.2	1.67
1978	-28.9	2.63
1979	-23.1	2.27
1980	-19.3	2.09
1981	-22.3	3.39
1982	-27.5	4.19
1983	-52.4	6.69
1984	-101.7	9.83
1985	-126.5	10.03
1986	-138.3	13.58
1987	-152.1	16.01
1988	-119.8	10.43

Sources:

1. U.S. government, Council of Economic Advisers, Economic Report of the President: transmitted to the Congress, January 1989, p.428.
2. Business American, "Current International Trade Position of the U.S.," Business American (June 5, 1989). p.18.
3. R.O.C., Executive Yuan, council for Economic Planning and Development, Taiwan Statistical Data Book, 1988, June 1988, p.215.
4. Free China Review, "Partner not Enemies." Free China Review (April 1989):1.

BIBLIOGRAPHY

Abuaf Niso. "Foreign Exchange Options: The Leading Hedge." Midland Corporate Finance Journal (Summer 1987):51-8.

Accountancy. "Management Accounting Practices, Study 2 -- Foreign Currency Exposure And Risk Management." Accountancy. (April 1987):150-6.

Accounting Research Monthly. "Several Considerations on Investing Abroad." Accounting Research Monthly (November 1, 1987):10-2.

Arpan, Jeffrey S., and Lee H. Radebaugh. International Accounting and Multinational Enterprises. New York: John Wiley & Sons, Inc., 1985.

Belkaovi, Ahmed. International Accounting: Issues and Solutions. Westport, Connecticut: Greenwood Press, Inc., 1985.

Business American. "Current International Trade Position of the United States." Business American (June 5, 1989):18.

Chang, Cecilia. "Everyone Wants To Be the 'Boss'." Free China Review (November 1988):10-2.

Chen, Che-Hung. "Taiwan's Foreign Direct Investment." Journal of World Trade Law (November-December 1986):639-64.

Cheng, Ti-Ying. "General Description of Taxation in the Republic of China." Finance Research (May 1, 1988):26-44.

Cheng, Ting-Wong. Intermediate Accounting. Taipei, Taiwan: Yi-Cheng Stationery & Press, Inc., 1984.

Choi, Frederick D. S., and Gerhard G. Mueller. International Accounting. Englewood Cliffs, NJ: Prentice-Hall, Inc., 1984.

-------, and Ashwinpaul Sondhi. "Views from Abroad." Journal of Accounting, Auditing & Finance (Summer 1985):335-40.

Clark, Cal. "Economic Development in Taiwan: A Model of a Political Economy." Journal of Asian and African Studies (1-2, 1987):1-16.

Collier's Encyclopedia, 1988. V.22. New York: Macmillan Educational Company, 1988.

Demirag, Istemi S. "A Review of the Objectives of Foreign Currency Translation." The International Journal of Accounting (Spring 1987):69-85.

"Don't Let the New Taiwan Dollar Be a Weak Currency." International Daily News, 2 April 1989, p.5.

Encyclopedia Americana, 1984. V.26. Danbury, Connecticut: Grolier International Inc., 1984.

"Enlarging The Domestic Demand Can Reduce the Pressure from the Appreciating New Taiwan Dollar." International Daily News, 15 April 1989, p.15.

"Exchange-Rate Movements Forecasted by A British Bank." International Daily News, 9 May 1989, p.12.

Fekrat, M. Ali. "Accounting for Forward Exchange Contracts." The International Journal of Accounting (Spring 1984): 83-92.

Feldstein, Martin. "Correcting The Trade Deficit." Foreign Affairs (Spring 1987):794-806.

Free China Review. "Background To The ROC 'Miracle'." Free China Review (April 1989):22.

Free China Review. "Partners Not Enemies." Free China Review (April 1989):1.

Garlicki, T. Dessa, Frank J. Fabozzi, and Robert Fonfeder. "The Impact of Earnings under FASB 52 on Equity Returns." Financial Management (Autumn 1987):36-44.

Gray, Dahli. "SFAS No. 52: Progress or Problem?" The International Journal of Accounting (Fall) 1984):109-19.

Guithues, Denise M. Innovative Reporting in Foreign Currency Translation. Ann Arbor, MI: UMI Research Press, 1986.

Hall, Thomas W. and H. Jim Snavely. "Translated Financial Statements Can Be Meaningful." The International Journal of Accounting (Fall 1984):153-70.

Hofstede, Geert. Culture's Consequences: International Differences in Work-Related Values. Beverly Hills, CA: Sage Publishions, 1980.

Hosseini, Ahmad and Raj Aggarwal. "Evaluating Foreign Affiliates: The Impact of Alternative Foreign Currency Translation Methods." The International Journal of Accounting (Fall 1983):65-87.

"Is the New Taiwan Dollar Really a Hard Currency?" Economic Daily News, 6 May 1989, p.2.

Ju, Lee-Jan. "Conference: How to Identify, and Analyze the Risks from A Fluctuating Foreign Currency?" Accounting Research Monthly (August 10, 1988):8-11.

Kochanek, Richard, and Corine Norgaard. "Foreign Currency Translation SFAS No. 52 Requirements and Implications." Akron Business and Economic Review (Summer 1985):6-13.

Li, Kun-Yi. "Ten Strategies to Avoid the Risks of Foreign Exchange." Accounting Research Monthly (August 10, 1988):15-7.

Lin, Chung-Hsiung. Money and Banking. Taipei, Taiwan: Jih-Sun Press Inc., 1988.

Martellaro, Joseph A. "United States-Taiwan Trade Relations and The Trade Deficit." Business Economics (July 1987):28-33.

McAllister, Liane. "Taiwan Rises to Economic Challenges." Gift & Decorative Accessories (June 1988):52 & 344.

McKinnon, S. M. and Paul Janell. "The International Accounting Standards Committee: A Performance Evaluation." The Journal of Accounting (Spring 1984):19-33.

Miller, David E. "Foreign Exchange Options." Cashflow (October 1985):23-4.

Nance, Jon R. and Roger A. Roemmich. "Foreign Currency Translation: An Evaluation." The International Journal of Accounting (Spring 1983):29-48.

-------. "Financial Statement Impact of Foreign Currency Translation Alternatives." The International Journal of Accounting (Fall 1983):89-113.

Nathans, Leah. "Watch the Bouncing Buck." Business Month (March 1988):70.

Nobes, Christopher and Robert Parker. Comparative International Accounting. New York: St. Martin's Press Inc., 1985.

Peagam, Norman. "Taiwan: Island of Ingenuity." Euromoney (May 1987):56-8.

Power, Christopher. "RJR's Foreign Coup." Forbes (September 12, 1983): 226.

"Problems between Commodity Prices and Exchange Rates." Economic Daily News, 7 May 1989, p.2.

"Problems with the Liberalization of Foreign Currencies." Economic Daily News, 3 May 1989, p.2.

Revsin, Lawrence. "The Rational Underlying the Functional Currency Choice." The Accounting Review (July 1984):505-14.

R.O.C. Council for Economic Planning and Development. Industry of Free China. Vol. LXXI No. 3. March 1989.

R.O.C. Council for Economic Planning and Development. Taiwan Statistical Data Book. 1988.

R.O.C. Executive Yuan. Directorate-General of Budget, Accounting & Statistics. Statistical Yearbook of the ROC. 1988.

R.O.C. Ministry of Economic Affairs. Investment Commission. Statistics on Overseas Chinese & Foreign Investment, Investment, Technical Cooperation, Outward Investment, and Outward Technical Cooperation. March 1989.

R.O.C. The Corporation Law of the Republic of China.

R.O.C. The Enforcement Rule of Income Tax Law of the Republic of China.

R.O.C. The Income Tax Law of the Republic of China.

R.O.C. The Securities and Exchange Law of the Republic of China.

Schweikart, James A. "We Must End Consolidation of Foreign Subsidiaries." Management Accounting (August 1981):15-8.

Stein, Jon. "How International Funds Hedge Their Currency Exposure." Futures (May 1988):40-1.

"Taiwanese Investment in South Asian." International Daily News, 1 June 1989, p.14.

The Economist. "Taiwan: Survey." The Economist (March 5, 1988):S3-18.

"The Incentives of Investing in The Dominican Republic Provided by The Taiwanese Government." International Daily News, 17 April 1989, p.6.

U.S. Council of Economic Advisers. Economic Report of the President: Transmitted to the Congress. January 1989.

U.S. Financial Accounting Standards Board. Statement of Financial Accounting Standard No. 52: Foreign Currency Translation. Stamford, CT: FASB, 1981.

Wu, Hui-Lin. "A Future For Small & Medium Enterprises?" Free China Review (November 1988):6-9.

Yang, James G. S. "Managing Multinational Exchange Risks." Management Accounting (February 1986):45-52.

Yu, Tzong-Shian. "Complexities Compounded." Free China Review (October 1988):26-9.