THE RECOGNITION OF THE DIFFERENCES IN THE EXCHANGE RATE GENERATED BY THE IMPORT-EXPORT OPERATIONS CARRIED OUT BY THE ECONOMIC ENTITIES FROM ROMANIA IN THE FINANCIAL STATEMENTS

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ABSTRACT: Nowadays the participation of all states in the world economical circuit is an objective necessity. The complexity of global economy, the extremely strong incidence of technical progress, the diversification of the economic processes, the emphasizing of the interdependences between national economies, the extremely important advantages that can be obtained from international specialization (or the dangers to which those that prefer autarchy are exposed), are just a part of the causes and factors that have led to the generalization – at a planetary scale – of the international economical exchanges. In this field we include our study of analysis and presentation of foreign transactions, which have as a main characteristic the expressing in a foreign currency, can generate differences in the exchange rate between the time of the appearance of the external debt/liability and the time of recording or presentation in the financial statements of the unaccounted for until the end of the financial period.

KEYWORDS: import; export; accounting information; external price; risk (currency); financial statements; currency.

1. Introduction

1.1 Motivation and methodology

"Through the development of foreign trade and international economic cooperation – writes Ph. D, Professor. Alexandru Puiu – each country can increase its economical potential, respectively the possibilities capitalizing its material and human resources in the direction of the development of production forces, promoting technical progress, superior capitalizing of natural resources, creation of new products, raising work productivity, higher qualification of the work force." [1:715]

Given the complexity and importance of the foreign trade operations, they represent, for accounting as well, an extremely important special field of research and application. This much more because in import – export operations partners from different countries are joined together, consequently the sphere of accounting information users grows larger. In these conditions, obtaining and transmitting relevant, credible and comparable information that utilizes a common accounting jargon enabling communication between all users categories is vital to the business environment.

The content of the present paper will be based on the deductive approach, starting from theory to practice, with some tendencies of inductive research which consist of practical case studies meant to verify the degree in which certain theoretical aspects, mentioned earlier are validated from a practical point of view. Practically, the tools of the deductive research used are case studies, through the descriptive/narrative method, but also the work tool materialized in the analysis of documents, especially of synthesis accounting documents. We can specify in this case that we used the quantitative method simultaneously with the qualitative on in the investigation. And, for the gathering of data, the main method used was the observation method.

1.2 Literature review

The complexity of the problems that are raised by external trade and especially the quantification of its importance for the economy of each country, have led to numerous analyses and conclusions, which, although in large terms differ one from another, being hard to find a common denominator applicable in practice, still they constitute the support of a fundamental direction in the development policy and strategy of an economy and of its external commerce. In this way, in the national literature, among the main authors preoccupied with the importance of external commerce for the Romanian economy, we mention: Ciobanu G. [2], Popa I.[3], Popescu G.[4], and of the ones that gave attention to the risk that these transactions are subject to in the currency fluctuation conditions we notice Vişan D., Buruda C., Burtescu C., Luţă D.[5]. These authors have started, however, directly from the premise that the currency fluctuations in which the import-export operations are expressed affect their efficiency and have suggested solutions for diminishing or even eliminating this currency risk. In the international literature, remarkable studies on this theme have been written by the following authors: Williamson J [6], Shapiro A. [7], Bartov E., Bodnar G. M.[8], Halpem L., Wyplosz C[9].

Financial instability is an international public bad, but not a classical one. Instability is not purely a technical by-product of the production of financial services. Rather, it is the outcome of market failures, for reasons not yet fully understood. [10:156] The Gordon M. Bodnar and Richard C. Marston model's demonstrates that foreign exchange exposure elasticities should be largest for pure exporting and importing firms, especially those with low profit margins. Exposure elasticities should be smaller for multinational firms that match their foreign currency revenues and costs [11:107]. Söhnke M. Bartram and G. Andrew Karolyi show that the reductions in market risk were concentrated in firms domiciled in the Euro area and in non-Euro firms with a high fraction of foreign sales or assets in Europe. The Euro's introduction led to a net absolute decrease in the foreign exchange rate exposure of nonfinancial firms, but these changes are statistically and economically small.[12:519]. In conclusion, Muller A. and Verschoor W.F.C said that „Assessing the sensitivity of firm value to exchange rate changes has been one of the most challenging issues in international financial management over the last two decades" [13:385].

2. The recognition of the differences in the exchange rate generated by the import-export operations in the financial statements

Preparing financial statements, as periodical reporting documents, mark the final stage of the annual data processing through which the activity of an economic entity that performs import – export operations is expressed. They are the result of applying hypotheses, assessment bases and principles specific to accounting and destined to reflect as precise as possible the financial position and the performances of an entity in order to serve the interests of a large scale of users of the accounting information. In economic literature, in order to reflect "the enterprise in financial terms" [14:22] at the end of the exercise different tools are used: balance sheet, accounting documents of synthesis, annual accounts, and financial statements. In the general sense, the documents of synthesis notion are used in accounting, to mark the fact that these statements assure the synthesis (syntax) of accounting information. [15:433]

At an international level, we find the problem of financial statements in the provisions of the international accounting norm IFRS 1"Presentation of financial statements", but also in other international accounting norms. Irrespective of the title under which we discover them in accounting or the normative act that regulates them, financial statements as accounting documents of synthesis represent for the users of the accounting information, the "data base" necessary in decision taking.

Thus, taking into account the users objectives and the decisions that these must also substantiate, financial statements demonstrate their utility through the following [16:386]: they represent a method of leading and analyzing, named as "the mirror" of the economic entity; they represent the main method of information of present and potential investors, business partners and the wide public, interested in the activity of the entity regarding the operations and transactions made in the reporting period and their effect on the financial equilibrium, on the registered financial results respectively; they constitute a calculation basis of the macroeconomic and sectorial indexes and of elaborating forecasts through the statistical date that it supplies regarding the patrimony and results of all economic entities.

In this paper we do not intend an exhaustive presentation of all the elements of an economic entity that can be comprised in the financial statements, but we will follow only those aspects relating to the specific of the import-export operations, to the modality of presenting them in the main components of the financial

statements, respectively. As main components of the financial statements, we included, unarguably, the Balance sheet, Profit and loss account, and, also, the Cash flow statement.

The Balance sheet presents the balance of cash and cash equivalents of an entity at the end of the period. By examining the balance sheets referring to two consecutive periods, we can state if the cash and cash equivalents have risen or fallen within a certain period of time. However, the balance sheet does not indicate why the balances of the cash and/or cash equivalents have varied on the course of the exercise. The profit and loss account presents information of the incomes, expenses and results emitted from different activities types – "keys" regarding the sources and uses of cash and cash equivalents, but not even this financial statement explains why the respective elements have risen or fallen. Moreover, not few times, behind significant profits, the profit and loss account can hide critical cash problems of the economic entity.

The table of cash flows presents such flows, known under the name of cash receipts and cash payments, in the course of the period. In other words, it shows where the cash came from and how it was spent, explaining in this way the causes of their variation. [17:80] The Cash flow statement belongs to the flow tables family, extremely useful tool for financial analysis, business assessments, diagnosing the situation of the enterprise, forecasts and other papers of economic-financial facture that are based in a large extent to the data from the financial statements. The cash flow table must present the cash flows of the exercise classified into operating, investment and financing activities. This synthesis document together with the Profit and loss account represents two fundamental elements that indicate the accurate dimension of performance of the company.

An import-export operation carried out in a foreign currency must be registered, when it is initially registered in the national currency, by applying the exchange rate between the two currencies, at the date of the transaction, to the value of the operation. Afterwards, at each date of the balance sheet, according to O.M.F.P no. 1.752/2005, the balance sheet accounts shown in foreign currency are treated as follows: the monetary elements (liquidities and assimilated elements, such as the letters of credit and bank deposits, accounts receivable and accounts payable) shown in foreign currency must be estimated and reported using the exchange rate established by the National Bank of Romania at the end of the financial year. The advantageous or disadvantageous differences between the exchange rate at the date of the recording (initial account) or the exchange rate at which the foregoing financial reports were put forward and the exchange rate at the end of the financial year, are accounted for as financial gains or losses according to the case; the non-monetary elements purchased in a foreign currency and accounted for/registered at the historical cost (non-current assets, inventories) must be reported using the exchange rate from the date of the transaction; the non-monetary elements purchased in a foreign currency and accounted at the fair value must be reported using the exchange rate form the date of the related estimation.

Due to this stipulation exchange rate discrepancies can thus appear in the following situations: *At the foreign currency liabilities' and receivables' maturity*, when exchange rate differences appear be they advantageous or disadvantageous, according to case, between the "historical" exchange rate[353] and the exchange rate at the time of payment. These differences are considered financial gains or losses according to case. When the foreign currency receivable or liability is paid during the same financial year it appeared, the whole exchange rate difference is acknowledged in that year. When the foreign currency receivable or liability is paid during the following financial year, the exchange rate difference acknowledged in each financial year that appears until the year of payment is determined by taking into account the modification of the exchange rates from each financial year; a*t the end of the financial year* when the unpaid *foreign currency receivables and liabilities* are *updated* to the exchange rate at 31.12. The exchange rate differences generated by this update are treated, like in the previous case, as financial gains or losses, according to case. In this way "the historical exchange rate" of the unpaid receivables/liabilities until the end of the year becomes the exchange rate as of the 31st of December; a*t the end of the financial year, the update of the foreign currency liquidities* is made, compulsorily, at the exchange rate from the end of the year, so that a correct piece of information is shown by the financial statements. This update also generates exchange rate differences, hence financial gains or losses, according to case.

[353] The "historical" exchange rate is considered, according to the new approach of the prudence principle, the exchange rate from the date that the receivable or liability in the foreign currency appeared, if this happened in the same financial year, respective the exchange rate from the end of the latest financial year, in case the receivable/liability, or a part of it, appeared in the previous financial year.

From all of the requirements mentioned above it clearly results the way in which financial statements for the foreign currency transactions are presented. Thus, the monetary elements must be presented in the Balance Sheet at the exchange rate from the end of the financial year, and the non-monetary ones at the exchange rate from the latest registration. In the Profit and Loss Statement/Account, the differences resulted from the update of the monetary elements, or payment of foreign currency receivables/liabilities, are presented as foreign exchange gains and/or losses at "Other financial incomes" or "Other financial expenses" respectively. In the elaboration of the Cash Flow Statement tough, there is the issue of exchange rate differences like the ones mentioned above that can or can not be acknowledged as cash-ins respective payments.

The cash flows do not contain the change in liquidities or liquidity equivalents because they are part of the economic entity's treasury management and a cash flow statement must show the incomings and outgoings of funds generated by the operational, investment and financial activities. Considering this we state our opinion that exchange rate differences that appear in the situations mentioned above can be viewed as unaccomplished according to the requirements on which the Cash Flow Statement[354] is based. . Of course that if the link with the transactions that generated them is considered, the differences may be accomplished, if they correspond with the payment of the transaction, or can be unaccomplished if they correspond with a transaction unpaid until the end of the year when the update of the foreign currency receivables, liabilities and liquidities takes place at the exchange rate from that time. However, we believe that no matter what transaction they are linked with (paid or not) the financial gains and losses from exchange rate differences do not generate cash and so they needn't be recorded in the Cash Flow Statement.

For the operations of an economic entity made in a foreign currency, all the three situations generate an unrealized profit or loss. However, only the third situation, i.e. the update of cash and cash equivalents at the end of the year using the exchange rate from that time, is shown distinctively in the Cash Flow Statement. This is due to the fact that the other two situations (the payment of foreign currency liabilities and receivables and the update of the unpaid liabilities/receivables at the end of the financial year) do not influence directly, through the registrations, the treasury accounts. Even if they are not distinctively reported in the Cash Flow Statement, foreign exchange losses and gains related to these two situations do not influence the Statement because, through the way in which it is presented based on its logic, they and their equivalents are indirectly eliminated.

Conclusion

The distinct presentation of the exchange rate variation effect on the cash and cash equivalents group is needed for bringing together these elements at the end of the period, and it is done as follows:

- When applying the *direct method of reporting* the operating flows, but also the investment and financial flows that are usually presented on a gross basis, the cash-ins and payments generated by foreign currency transactions will be presented at the exchange rate at the date of the cash flow. In this way we directly consider the exchange rates from the date of the cash flows for foreign currency transactions, disregarding the other balance sheet accounts and the implicated results, and also the exchange rate differences that are incorporated. Thus the cash-ins and payments related to the foreign currency transactions during the period are obtained.
- When applying the *indirect method of reporting* the operating flows: the losses and gains that reflect the exchange rate differences related to the update of the cash and cash equivalents group are annulled from the net book result. In this way the exchange rate differences generated by the update of cash and cash equivalents are eliminated from the operational flows group; the liquidities are recorded in the last group of the Cash Flow Statement for their initial and final balance accounts, including, for now, the exchange rate differences that have no connection with cash (generated by the update of liquidity); these differences must be annulled for the respective balance accounts to reflect the cash existence. The way in which

[354] There are opinions that state the fact that the foreign exchange differences related to the transactions paid during the year must be considered accomplished when the Cash Flow Statement is made because they generate payments or returns.

this is done is presented in the standard, on a distinct line, in the cash and cash equivalents group, under “Exchange rate variation effect”.

Thus, the unaccomplished gains and losses that result from the variation of the exchange rate between the date of the flows and the end of the year are not cash flows. However, the effect of the exchange rate variations related to liquidities and liquidity equivalents owned or owed is presented in the Cash Flow Statement, in order to allow the comparison between the liquidities and the liquidity equivalents related to the beginning and the end of the year. They are presented separately from the cash flows generated by the operational, investment and financial activities.

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