LO.a: Distinguish among presentation (reporting) currency, functional currency, and local currency.

1. Analyst 1: The preferred functional currency for subsidiaries that are mostly independent of the parent is the local currency.
   Analyst 2: For highly integrated subsidiaries (regardless of local conditions), or for subsidiaries operating in high-inflation environments, the parent's reporting currency should be used as the functional currency.
   A. Analyst 1 is correct.
   B. Analyst 2 is correct.
   C. Both analysts are correct.

LO.b: Describe foreign currency transaction exposure, including accounting for and disclosures about foreign currency transaction gains and losses.

2. If the functional currency strengthens against the foreign currency, then which of the following transactions will incur a loss?
   A. Import purchase.
   B. Export sales.
   C. Both import purchase and export sales.

LO.c: Analyze how changes in exchange rates affect the translated sales of the subsidiary and parent company.

3. An US firm owns a foreign subsidiary in India. In 2014, sales were INR 10,000,000 and the INR/USD exchange rate was 60. In 2015, the sales remained constant at INR 10.000,000 but the exchange rate was 65. What will be the impact of the change in the value of the USD on the parent company's translated sales?
   A. Sales will increase by 7.69%.
   B. Sales will decrease by 7.69%.
   C. Sales will decrease by 9.64%.

LO.d: Compare the current rate method and the temporal method, evaluate how each affects the parent company's balance sheet and income statement, and determine which method is appropriate in various scenarios.

4. Analyst 1: Under the current rate method, the foreign currency translation gain or loss will appear on the parent firm's income statement.
   Analyst 2: Under the temporal method, sales, COGS and depreciation are remeasured using the historical rate.
   A. Analyst 1 is correct.
   B. Analyst 2 is correct.
   C. Both analysts are incorrect.

LOe: Calculate the translation effects and evaluate the translation of a subsidiary's balance sheet and income statement into the parent company's presentation currency.

5. Which of the following ratios will most likely be affected by translation under the current rate method?
   A. Net profit margin.
   B. Debt/Assets ratio.
   C. Fixed asset turnover ratio.

LO.f: Analyze how the current rate method and the temporal method affect financial statements and ratios.

6. Analyst 1: When current rate method is used for translation, most of the financial statement relationships and ratios are preserved.
   Analyst 2: When temporal method is used for translation, most of the financial statement relationships and ratios are distorted.
   A. Analyst 1 is correct.
   B. Analyst 2 is correct.
   C. Both analysts are correct.

LO.g: Analyze how alternative translation methods for subsidiaries operating in hyperinflationary economies affect financial statements and ratios.

7. For a company with a foreign subsidiary in a hyperinflationary economy, which of the following accounting standards require using the temporal method for translating the financial statements?
   A. IFRS.
   B. US GAAP.
   C. Both IFRS and US GAAP.

LO.h: Describe how multinational operations affect a company's effective tax rate.

8. Which of the following statements is *least accurate* for an entity with operations in multiple countries with different tax rates?
   A. Its effective tax rate is not affected by the transfer prices it sets.
   B. Its effective tax rate will be lower if it sets a transfer price such that a higher portion of its profit is allocated to lower tax rate jurisdictions.
   C. Generally multinational companies have to pay income taxes in the country in which the profit is earned.

LO.i: Explain how changes in the components of sales affect the sustainability of sales growth.

9. Two multinational companies, A and B have reported the same sales growth rate. Growth in sales of A came from changes in volume and price. On the other hand, growth in sales from B came from changes in exchange rate. All else equal, the *most appropriate* conclusion is that:
   A. Company A's growth is more sustainable than Company B.

B. Company B’s growth is more sustainable than Company A.
C. Both companies have sustainable growth rates.

LO.j: Analyze how currency fluctuations potentially affect financial results, given a company’s countries of operation.

10. Dexta Pharma has its operations based in the United Kingdom. Due to favorable interest rates, the company borrows in US dollars. All else equal, an appreciation in the US dollar will:

    A. Increase profits
    B. Decrease profits
    C. Leave profits unchanged

Solutions

1. C is correct. Both statements are correct.

2. B is correct. The exporter is exposed to FX risk as the functional currency may strengthen against the foreign currency. This will decrease the amount of functional currency that the exporter will receive. On the other hand, strengthening of the functional currency benefits an import purchase transaction.

3. B is correct. While sales were flat at INR 10,00,000 in local currency terms, after translation the parent firm would report sales of USD 153,846.15 for 2015 (= USD 10,000,000 / 65) versus sales of USD 166,666.66 for 2014 (= USD 10,000,000 / 60). This represents a decline of 7.69%.

4. C is correct. Under the current rate method, the foreign currency translation gain or loss appears on the parent firm's balance sheet in the equity accounts. Under temporal method, sales are remeasured using the average rate, whereas COGS and depreciation are remeasured using the historical rate.

5. C is correct. All pure income statements and balance sheet ratios are unaffected by translation under the current rate method. The fixed asset turnover ratio is not a pure ratio; it consists of an income statement measure (sales, translated at the average rate) and a balance sheet measure (fixed assets, translated at the current rate).

6. C is correct. Both statements are correct.

7. B is correct. IFRS and US GAAP differ substantially in their approach to translating the foreign currency financial statements of a subsidiary in a hyperinflationary economy. US GAAP requires that the financial statements be translated using the temporal method. IFRS require financial statements to be first restated for inflation and then inflation adjusted financial statements be translated at the current exchange rate.

8. A is correct. Multinational operations affect a company's effective tax rate because of the ability to set transfer prices.

9. A is correct. Growth in sales that comes from changes in volume or price is more sustainable than growth in sales that comes from changes in exchange rates.

10. B is correct. When the US dollar would appreciate, the company's finance costs will increase causing profits to decline.

