Exercise 11-1

Brico Enterprises, a US corporation, acquired an 80% interest in Bandar Distributors in June 2012 when 1 FC equaled $1.62. Bandar is a foreign corporation whose functional currency is the foreign currency. The condensed pre-closing comparative trial balance for Bandar for the current year ended December 31, 2015 is given. Dividends are declared on March 1 of each year and are paid on March 31 of that year. The translated balance in retained earnings at the beginning of 2014 is $227,300.

You are given relevant exchange rates for 2014 and 2015.

(1) Determine the balance in the cumulative translation adjustment account as of December 31, 2015.

Because the functional currency is the foreign currency, the current rate method is used.

Under the current rate method, assets and liabilities are translated using the current rate; common stock and additional paid-in-capital are translated using the historical rate; retained earnings is translated based on the beginning of year balance increased for the translated income using the weighted average rate, and reduced for the translated dividends using the historical rate; income statement accounts are translated using the weighted average rate.

First, determine the translated retained earnings as of 12/31/14:

Item	In FC	Rate	In $
Beginning R/E	140,000	Given	$227,300
2014 income	180,000	1.92	345,600
2014 dividend	(30,000)	1.82	(54,600)
12/31/14 retained earnings	290,000		$518,300

Item	**In FC**	**Rate**	**In $**
Current Assets	165,000	$1.92	$316,800
Long-lived Assets	420,000	1.92	806,400
Other Assets	170,000	1.92	326,400
COGS	525,000	1.96	1,029,000
Other Expenses	205,000	1.96	401,800
Current Liabilities	(175,000)	1.92	(336,000)
Other Liabilities	(125,000)	1.92	(240,000)
Net Sales	(820,000)	1.96	(1,607,200)
Dividends Declared	25,000	2.02	50,500
Common Stock	(100,000)	1.62	(162,000)
Retained Earnings, 1/1/15	(290,000)	Computed	(518,300)
Cumulative Translation Adjustment		Plug	(67,400)
Total	$ 0		$ 0

2. Determine how much of the cumulative translation adjustment balance as of December 31, 2015, is traceable to the years prior to 2015.

Net assets 1/1/15 multiplied by change in exchange rates 390,000 x (1.92 – 1.95)	$11,700
Increase in net assets (excluding capital transactions) multiplied by difference between current and average rates 90,000 x (1.92 – 1.96)	3,600
Increase in net assets from capital transactions multiplied by current and historical rates: 25,000 x (1.92 – 2.02)	(2,500)
Cumulative translation adjustment at 12/31/15	(67,400)
Cumulative translation adjustment at 12/31/14	$(80,200)

3. Given your answer to part 2, verify your answer by using an alternative approach to calculating the amount of the cumulative translation adjustment that is traceable to years prior to 2015.

Item	In FC	Rate	In $
Current Assets	185,000	$1.95	$360,750
Long-lived Assets	400,000	1.95	780,000
Other Assets	165,000	1.95	321,750
COGS	425,000	1.92	816,000
Other Expenses	260,000	1.92	499,200
Current Liabilities	(135,000)	1.95	(263,250)
Other Liabilities	(225,000)	1.95	(438,750)
Net Sales	(865,000)	1.92	(1,660,800)
Dividends Declared	30,000	1.82	54,600
Common Stock	(100,000)	1.62	(162,000)
Retained Earnings, 1/1/14	(140,000	Given	(227,300)
Cumulative Translation Adjustment		Plug	(80,200)
Total	0		$ 0

4. Assume that Brico borrowed 100,000 FC on March 1, 2015, as a hedge against its investment in the subsidiary. Determine how much of the parent's interest in the current year translation adjustment could have been offset by this hedge assuming that the loan remains unpaid as of year-end 2015.

Change in 2015 Translation Adjustment Due to Hedge	
12/31/15 value (100,000 x $1.92)	$192,000
Less: 3/1/15 value (100,000 x $2.02)	(202,000)
Change in value of loan payable	$ (10,000)
Parent's 80% share of 2015 translation adjustment before adjustments related to subsidiary acquisition (80% x 12,800)	10,240
Net effect of translation on parent's OCI	$240