

FOREIGN CURRENCY FLOW STATEMENT:

A Warranted Inclusion in Corporate

Annual Reports

By
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Abstract

Ability of a country to generate foreign currency is a key aspect of economic health. Yet, contents of individual economic entities' financial reports in this country do not reflect information on such an important variable. The general body of users of financial reports' information stand to benefit severally by inclusion of such information. However, outside corporate annual reports they would not have alternative information sources. Therefore, an argument is put forward for appending a foreign currency flow statement in published financial reports.

Cost of providing that additional information is justified by the benefits accruing to users as a result of disclosure. However, in order for such disclosure to yield intended results it must be comprehensively required from entities transacting in foreign currency. Also, it must incorporate the qualitative characteristics of good accounting information.

INTRODUCTION

The primary concern of financial reporting is to communicate information of financial nature to users of such information. Objectives of financial reporting have traditionally focused on two

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prominent groups of users of financial information. These are the owners and creditors. Interests of other users are assumed to be accommodated within the interests of these two groups of users. Financial reporting, to these users, should aid the process of making rational investment and credit extension decisions. It should enable present and prospective investors and financiers to assess amounts, timing and uncertainty of expected cash flows from a reporting entity. It should also convey information on the magnitude of resources an entity commands and how those resources have been financed.

This approach, focusing at interests of investors and creditors, subordinates interests of other users of financial reports. Changes in the economic environment have produced increased demand on corporate reports to disclose more information. These demands emanated from not only shareholders and credit providers but also other users of financial reports. With a view to addressing this matter, the Corporate Report (1975) categorized users into seven groups and identified their informational interests. The Corporate Report suggested that information be provided to satisfy interests of those seven groups of users. The Corporate Report raised some very fundamental issues on reasonable rights to information of different users. Unfortunately, in the ensuing years after it was published it did not receive the attention it deserves.

There are difficulties associated with accommodating interests of seven groups of users in one set of financial reports. Also, the production of additional information increases the immediate costs of processing information on the part of reporting entities. As such, there was some resistance to and dissenting views on some of the contents of the Corporate Report from several corners.

Nevertheless, taking account of serious limitations of the existing "markets" to regulate supply and demand of accounting information, interests of users have to be addressed by intervening regulatory authorities. This process starts with identification of financial information which is most useful to decisions of users. That information must also embody the qualitative characteristics of good accounting information; these are understandability, relevance, reliability, timeliness, objectivity and verifiability. Finally, an assessment of costs of providing the information and the benefits derived from use of the information is made. Provision of additional information is only justified if

benefits from use of that information exceed the costs of providing it.

This contribution, from the users' interests approach, argues for provision of information on how entities have generated or received foreign currency and how that currency has been conserved, invested or expended. We shall briefly discuss the importance of foreign currency to the Tanzanian economy and appraise the existing financial reporting requirements regarding foreign currency. Arguments and justification for provision of additional information will be put forward and then a schedule is presented to suggest the nature of information thought to warrant disclosure.

Foreign currency as an important variable

Foreign currency is an important variable to economies of all countries, more so to developing ones. Tanzania, as one of developing countries has a large external debt burden standing at US \$250.50 per capita in 1990 when compared to an income per capita of US \$110 in the same year (World Bank, 1993). There is a persistent overall balance of payment deficit problem recorded at US \$294.2 million in 1990. In 1991 there was an improvement, and the deficit stood at US \$260.8 million (BoT, 1993). There are also problems of corruption, abuse and misappropriation of national and corporate resources, both domestic and foreign (Senkoro, 1988). These deficiencies are attributable to diminished foreign currency earning capacity in times of increasing imports. Weaknesses in management and control of foreign currency and other assets further compound the problem. Some of these deficiencies call for macro level remedial measures. However, at micro level, individual economic units have a significant contribution to make towards their solution. The focus of this discussion is on individual economic units.

Existing Foreign Currency Disclosure Requirements

Financial statements as currently presented by reporting entities in the country do not meet even the existing disclosure requirement with regard to foreign currency transactions. Compliance with the current disclosure requirements has been found to be weak. Requirements of TSSAP 2 in relation to

foreign currency transactions are among the least popular items of disclosure in Corporate Annual Reports published in Tanzania (Abayo, 1992).

Tanzania Statement of Standard Accounting Practice 2 (TSSAP 2) requires disclosure of the following:

- (a) Earnings in foreign exchange classified under:
 - i) export of goods (calculated on FoB basis)
 - ii) royalty, knowhow, professional and consultation fees earned
 - iii) interest and dividends earned
 - iv) other income with brief description of their nature.
- (b) Foreign currency outlay on imports, calculated on CIF basis and classified among:
 - i) raw materials
 - ii) components and spare parts
 - iii) capital goods.
- (c) Foreign exchange outlay, classified separately, on royalty, knowhow, professional and consultation fees, interest payments and so on.
- (d) Amount of dividends remitted in foreign currency
- (e) Foreign currency component of the emoluments paid during the accounting period to expatriate staff, if any, reckoning for this purpose the periodical remittance permitted and the appropriate portion of the leave pay applicable to the period; stating also the number of expatriate employees involved. Comparative figures in respect of the preceding period shall also be stated.
- (f) Efforts at import substitution, indicating the values of all imported, the value of all indigenous raw material, spare parts and components consumed, and the percentage of each to the total consumption, along with a comparison with similar ratio computed in respect of the previous accounting period.

This disclosure requirement is laudable since it is a meritorious attempt to incorporate in published financial statements disclosure of matters relating to foreign currency transactions. However, even if a reporting entity complied with TSSAP 2, one cannot measure contribution of that enterprise towards earning and conserving foreign exchange, the stated objective of this disclosure requirement. It does not provide for disclosure of the net inflow or outflow of foreign currency, after all items of

disclosure are taken account of. It is also for example, silent on the currency of disclosure, whether it is Tanzanian shillings or in original currency of transaction or in one international currency. Consequently, a concise, uniform format of disclosure has to be adopted. Entities should be required to disclose sufficient information on foreign currency transactions in their financial statements for an able assessment of their performance to be made.

Arguments for additional disclosure

A fundamental objective of corporate reports is to communicate economic measurements of and information about the resources and performance of a reporting entity useful to those having reasonable rights to such information (The Corporate Report, 1975). A foreign currency flow statement will communicate information about an important resource to users of accounting information. These are the government, shareholders, loan financiers, business analysts, consultants, employees and the general public. The increase in the wealth of information available to these users as a result of additional disclosure will improve quality of their decisions.

Foremost, foreign currency is generated through efforts of the peasantry, workers and the business community. These make possible the export of primary and secondary goods and also export of services. Even when entities' source of foreign currency finances is external, eventually it is the country's foreign currency reserves which are depleted in repayment of loans and loan interest payments. The public therefore, has reasonable expectation to be informed of how individual economic units have fared in generating foreign currency and how that foreign currency has been expended.

Management, on the other hand, as stewards of entities on behalf of individual shareholders or governments, has an obligation to communicate to owners the extent to which it has performed the function of stewardship. Foreign currency management is one area where owners, it is assumed, will want to appraise management performance. Entities, therefore, have an obligation to disclose information concerning management actions to those, like owners, who have a right to require or reasonable expectation to receiving such information.

Moreover, a sizeable volume of export trade activity has been

undertaken by parastatals. Some of these were especially established for export marketing. Export trade involves significant foreign currency related transactions. Users of financial statements of these entities expect to receive some information on performance in this area of managing foreign currency. The parastatal sector is currently being opened up to private investors. This will result in shrinkage of parastatal activity. Nevertheless, there will be left a number of parastatals with enough strength to compete. Attention needs to be focused on these. Boards of directors in these parastatals were observed to be weak (Mwapachu, 1983; Senkoro, 1988). This was then justified by the fact that, at that time, government employees, though inexperienced in business, were the only few individuals who could have been appointed to boards of parastatals. Today, that is not the case. There is a growing cadre of experienced business strategists in and outside the parastatal sector. However, boards of parastatals have not changed much. As a result, they have not been effective agents in overseeing management actions. Weak and ineffective boards create room for abuse by management. Foreign currency is one of those vulnerable areas which require special attention in these organizations. In this regard therefore, specific reporting requirements for foreign currency transactions will improve accountability by management.

Foreign currency transactions also expose entities to foreign currency risks. Investors and financiers will be interested to know the level of involvement and risk exposure of an entity in foreign currency transactions. Also, they would like to know management actions taken to manage those risks. Additional disclosure will focus interest in this important area. In the US for example, after introduction of the Statement of Financial Accounting Standard No.8 (SFAS8), Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements, follow up studies showed SFAS8 had significant impact on the foreign exchange management practices of companies (Underdown and Taylor, 1985).

Tanzania Statements of Accounting Guidelines No.1 Accounting for Foreign Currency Transactions became operative in 1990. Its impact on Foreign exchange management practices of Companies has not been measured yet. However, it addresses only translation of foreign currency transactions in financial Statements. As such, the guideline does not provide users with

information which can be used to measure flows in Foreign currency funds.

Current moves to liberalize trade usher in an era where private entrepreneurs will play even a larger role in the areas traditionally dominated by parastatals. Multinational companies have commenced operations in the country and existing ones may expand their activities. Yet, more may be attracted to invest in the country. It is of vital importance to ensure that such companies are net contributors of foreign currency and not net users. Entities should not become a burden on the country's foreign currency reserves. This aspect can be monitored if companies were required to report separately in summarized form, all foreign currency transactions.

Proponents of the efficient market hypothesis would argue that the risk-return trade off is the criteria for guiding investors in efficient allocation of resources. Whether returns and cash flows are expressed in US \$, German DM or TShs, it should not make any impact on contents of information. In perfect efficient market conditions that would be acceptable. In reality, it does make a difference because of imperfections in world commodity markets and financial markets.

When even industrialized countries threaten a trade war because of trade imbalances between themselves, the matter of foreign currency earning capacity would be even more crucial for a developing country like ours, which has chronic trade imbalances with most of its trading partners.

Cost-Benefit Justification and Other Considerations

If accounting information was able to be subjected to the forces of demand and supply as a "good", those willing to pay the market price would avail of additional accounting information. Unfortunately, accounting information is such that it has some characteristics of a "public good". Firstly, an individual's consumption of accounting information leaves such information intact for others to use. Once it is published the cost of an additional consumer is negligible. Secondly, accounting information in financial reports cannot be supplied privately, one cannot package publishable accounting information to suit only one buyer. An individual therefore, cannot be prevented from receiving benefits of accounting information, the moment it is published. Consequently, because of these attributes of a public

good contained in published financial statements, some intervention activity by regulatory authorities is arguably, justified to decide what should be disclosed. In order to arrive at a decision on disclosure of additional information, an assessment of costs and benefits has to be undertaken.

Provision of information, as always, has its attendant costs. As such, expected benefits from the use of such information should exceed costs of its provision. Benefits which justify the foreign currency flow statement are in the main, qualitative. Consequently, a figure of monetary value associated with benefits of additional disclosure cannot be readily derived. Nevertheless, that figure could be estimated with surrogate values if one set out to measure, in monetary terms, the increase in quality of economic decisions made by users of accounting information as a result of additional disclosure. The use of surrogate values involves a large element of subjectivity such that eventually, benefit estimation depends upon one's judgement about the cost and worth of the information (Dasgupta, et al, 1978). That notwithstanding, qualitative considerations are always an important input in decision making. As such, they should be weighed, albeit subjectively, against expected costs of providing desired information.

Production of information on foreign currency transactions does not require substantial change to the information processing systems currently in place. There is already information available within entities relating to foreign currency transactions which would just need presentation in a suitable format. As such, information on foreign currency flow could be generated within currently available information systems at little incremental cost. Considering the qualitative benefits detailed earlier, such cost is justifiable.

There are two other main considerations which should determine whether production of desired information is worthwhile (Foster, 1986). These are:

- i) The potential for the information to reduce uncertainty; If substantial improvement occurs in decision making and/or monitoring because of use of such information then there is an argument for such additional information to be disclosed.
- ii) Availability of alternative information sources; If information intended to be disclosed can be obtained directly, reliably, timely and at a lower cost from

alternative information sources then it need not be disclosed.

The foreign currency flow statement will improve decision making and monitoring on the part of users of financial reports. The general body of users of financial reports currently does not have any alternative sources for information of this nature.

On both counts above therefore, there would seem to be a case for production and disclosure in annual financial reports, of transactions in foreign currency by reporting entities in this country.

Format of Disclosure

Following is a schedule suggested as an appendix to corporate annual reports. It is thought that its informational content will be desirable to the general body of users of accounting information. Also, instead of using one common currency, it is suggested that movements should be shown in major currencies transacted.

SCHEDULE OF MOVEMENTS IN FOREIGN CURRENCY FUNDS

	US \$	UK £	DM	JY
Currency Inflows:				
Export Earnings				
Borrowing				
Grants				
Conversion from other currency				
Other sources				
Total Currency Inflow				
Currency Outflows:				
Conversion to other currency				
Revenue Expenditure				
Overseas travel				
Wages to expatriates				
Professional fees				
Consumable spare parts				
Other items				
Capital Expenditure				

	US \$	UK £	DM	JY
Vehicles less than 6 passengers				
Other vehicles				
Machinery and equipment				
Other items				
Dividends				
Interest payments				
Loan repayments				
Foreign investments				
Total Currency Outflow				
Net Currency Inflow/(Outflow)				
Opening Balance				
Closing Balance				

Limitations

Whatever benefits accruing to users as a result of the suggested inclusion of the statement of foreign currency flows, they will be derived only from published corporate reports. There are a number of entities commanding a share of export and import business which are not corporations. Therefore, they have no obligation to abide by disclosure requirements. Until measures are suggested to encourage alternative disclosure avenues for these entities, they cannot contribute to the wealth of information derived from disclosure as argued for in the main discussion.

Additionally, the suggested inclusion in corporate annual reports of the foreign currency flow statement will not escape the deficiencies found in published financial statements, more so in parastatal organizations. Similar observations have also been made in private companies (Rutihinda, 1991). These weaknesses include material and fundamental errors and inaccuracies in the accounting information and lack of timeliness in publishing financial statements (TAC, 1988-1992). Therefore, additional information concerning foreign currency transactions would result in intended benefits only if it could incorporate the attributes of

good accounting information as introduced earlier. It is noted however, that efforts have gone into addressing weaknesses in financial statements of parastatals and positive results have been forthcoming. The quality of accounting information looks certain to make further strides for the better.

CONCLUSION

This discussion has put forward a suggestion for improving financial statements published in this country. Ability to earn and conserve foreign currency is a key variable to the well being of the economy. As such, there are assumed benefits to users of corporate report's information resulting from additional disclosure regarding foreign currency transactions. Probably, an empirical study directed towards establishing the actual benefits to be derived in the field from such disclosure could provide more information on desirability of the foreign currency flow statement. Users' preferences of information to be contained in the statement could also be established in that exercise.

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