

6-1921

Students' Department

H. A. Finney

Follow this and additional works at: <https://egrove.olemiss.edu/jofa>



Part of the [Accounting Commons](#)

Recommended Citation

Finney, H. A. (1921) "Students' Department," *Journal of Accountancy*. Vol. 31: Iss. 6, Article 7.
Available at: <https://egrove.olemiss.edu/jofa/vol31/iss6/7>

This Article is brought to you for free and open access by the Archival Digital Accounting Collection at eGrove. It has been accepted for inclusion in Journal of Accountancy by an authorized editor of eGrove. For more information, please contact egrove@olemiss.edu.

Students' Department

EDITED BY H. A. FINNEY

FOREIGN EXCHANGE

As one of the results of the world war, the foreign trade of the United States has been greatly stimulated, while the foreign exchange situation has been greatly disturbed. When exchange is restored to something like a normal condition and when European countries adjust their domestic and international affairs so that they can come again into the markets of the world on something like a pre-war basis, American foreign trade will unquestionably be greatly in excess of what it was before the war. It will then be necessary for all those who are engaged in producing anything which is in demand in foreign countries to understand the methods employed to settle accounts with their customers in those countries. This knowledge is equally essential to those who import foreign goods or who own enterprises conducting branches in foreign countries. Accountants will have to understand the principles involved in the accounting for foreign commerce and the conversion of foreign balances.

If all countries used the same form of coinage, were all on a gold basis and if all kept their circulating medium at par with gold, the problems connected with international finance would be comparatively simple and would not differ much from those connected with domestic exchange.

Domestic exchange forms the medium for the settlement of accounts within the boundaries of a single country or of a section of that country. For this purpose each of the large cities of the United States acts as a clearing house for the territory tributary to it, and New York is used as the clearing house for the whole nation.

If a cotton factor in Arkansas sells a lot of cotton in St. Louis, he could require the purchaser to send him the proceeds in actual currency by express. Not only would this be expensive; it would also be useless, because the factor has paid for the cotton by a cheque on his local bank and does not need the cash. When he shipped the cotton he probably drew on the purchaser with bill of lading attached, and sold the draft to his local bank as St. Louis exchange. If this were all, the local bank would have a credit with the St. Louis bank to which it sent the cotton draft, and this credit would be useless to it, unless it requested the St. Louis bank to ship currency, which is open to the same objection as in the case of the factor.

But this is not all. Several merchants in that section are obliged to pay for goods which they have purchased in St. Louis. They could go to the trouble and expense of sending money by express, but it is easier and cheaper to go to the local bank and buy drafts on St. Louis payable to their creditors in that city. In this way the proceeds of the cotton factor's draft are made to pay the bills of the local merchants. The bank acts as the intermediary in this exchange of credits, perhaps charging a small commission which is called exchange. This creates confusion in some minds, since the drafts and the bank's charges are each called by one name: exchange.

The Journal of Accountancy

An element enters into the transactions of this character which is known as "the balance of trade." When shipments to St. Louis are steadily larger in value than the remittances of local merchants to their St. Louis creditors, the local bank's balance in St. Louis becomes too large and the balance of trade is against St. Louis. The local bank may be obliged to protect itself against the accumulation of a large balance in St. Louis of which it is unable to dispose, and as a means of protection it may charge the factor a commission, or exchange, on his draft on St. Louis. It is then said that St. Louis exchange is at a discount.

On the other hand when shipments to St. Louis are largely reduced, while the local merchants are still buying drafts, the balance of trade is in favor of St. Louis, and the local bank may be obliged to ship currency to St. Louis to keep its credit good or deposit in St. Louis cheques and drafts on other cities. It now protects itself by charging exchange on the drafts it sells, and St. Louis exchange is said to be at a premium. Of course, the extreme rates of discount and premium are governed by the cost of shipping currency.

As St. Louis and other large cities act as the settling agents for their respective sections, so New York has acted in the same capacity for the whole country. The larger territory covered allows more extensive transfers of credit than is possible in a single restricted section, because when the balance of trade is against one part of the country it is virtually sure to be against New York in another part. St. Louis may have too large a balance in New York when Chicago's balance is too small. St. Louis can then sell Chicago exchange on New York. If any settlement is then necessary between Chicago and St. Louis it can be made by a shipment of currency for the short distance between these two cities. Otherwise Chicago would have to ship currency to New York and New York would have to send an equivalent amount of currency to St. Louis. The short and inexpensive transfer along the base of the triangle saves both time and expense as compared with the transfer over the two long sides.

The movements of foreign exchange are governed by the same principles as are those of domestic exchange. The proceeds of the exports made by the United States to Europe are used to pay for imports from Europe and for the expenditures in normal times of the large number of American tourists abroad. When this country ships more than it receives in goods or spends abroad, the balance of trade is in our favor. This balance must be settled in gold. As it is very expensive to ship gold and as foreign banks do not wish to deplete their stock of the precious metal beyond a certain point, the expedient of raising the rate of interest allowed to American banks on their deposits is often adopted. If there is a prospect of a reversal of the balance of trade later, the American banks can afford to carry heavy balances in Europe, because they not only receive a good interest on their money but also make a profit by buying drafts on Europe at a low rate when they are plentiful and selling their own drafts at a high rate when European drafts are scarce.

When the balance of trade is against this country, the reverse action takes place and we have to ship gold to establish the equilibrium. But since it often happens that the balance of trade may be against us in one

Students' Department

country and in our favor in another, settlement may be made by a transfer of funds from the debtor to the creditor country.

London has been the clearing house for the world because the British banking system has branches in all commercial countries. In many places the only way to make a payment in any other country is by means of a draft on London. Until Germany committed financial as well as military suicide, she was attempting to make Berlin a secondary clearing house at least, by the establishment of German banks in important commercial cities throughout the world.

Until the passage of the federal reserve bank law, no banks in the United States could have a branch in a foreign country. Hence this country was almost entirely dependent upon British banks in its commerce with countries with which it did not have direct connection. This worked against the American merchant in more ways than one. The British branch bank in Buenos Aires, for instance, would always discriminate in favor of British merchants in the extent of its accommodations, if not in the rate of exchange, and the American merchant would receive his pay in a draft on London, which he would have to sell. He would thus pay exchange twice—once when his agent bought the draft in Buenos Aires, and again when he sold it in New York. In addition, he never knew how much he was to receive as his final proceeds until he received and sold the draft on London.

Banks in the United States are now authorized to establish branches in foreign countries and they have already done so in some of the principal cities of South America. Transactions between Argentina and the United States can now be settled in terms of dollars directly with New York instead of in sterling through London.

If all the commercial nations of the world were using gold as the standard of value instead of silver or an inflated paper currency, the problems of foreign exchange would be only those arising from the varying balance of trade and the cost of shipping gold from one country to another. When one country is on a gold and another on a silver basis, another complication is added: the variations in the relative values of the two standards. These variations depend on the price of silver bullion in the world market.

If a silver country owes a gold country \$1,000 in the currency of the silver country, it must buy a draft on the gold country payable in gold of the value equivalent to 1,000 silver dollars. In addition to the other variations, there is also a question as to the equivalent values of gold and silver. If the price of silver bullion is such as to make a silver dollar equal to fifty cents in gold, a draft for \$500 gold will pay the debt of \$1,000 silver. If silver has risen so that a silver dollar is worth sixty cents in gold, the draft must be for \$600. It makes no difference to the man in the silver country, for he pays \$1,000 in his own currency in either case, but the man in the gold country makes or loses with the rise or fall in the price of silver.

On the other hand, if the debt is for \$1,000 in gold, the man in the silver country must pay \$2,000 in silver currency for it when the silver dollar is worth fifty cents, but only \$1,666.67 when his dollar is worth sixty cents. In this case the man in the gold country is not affected, for

The Journal of Accountancy

he receives \$1,000 in gold in either event, but the man in the silver country saves money when silver rises and loses it when it falls.

If a concern whose main office is in a gold country invests in a branch in a silver country, such as a coffee plantation, the accounts in the home office will be in gold values and those at the plantation will be in silver. When a statement of the operations and condition of the whole concern is made by the home office, the values must be in gold. The process by which the one value is changed into the other is called the conversion of values.

There are no complications when a merchant in America sells goods to a merchant in a silver country such as China, at once draws a draft for the agreed price, attaches the bill of lading for the goods and sells the draft at once to an American bank. The American merchant treats the proceeds of the draft as the selling price of the goods and entirely ignores the fact that the draft was drawn in a foreign currency. In the same way if he imports goods from China the cost of the goods is the amount of the draft drawn on him. The same would be true in the case of goods shipped to or received from a gold country. The only complication would arise in case we were obliged to quote a price in the currency of the foreign country some time before he would be able to make the shipment. If exchange took a sharp turn against him, his profit would be reduced, while on the other hand a favorable turn would increase his profit.

The par of exchange is the value of one currency expressed in terms of another currency, based on the bullion value of each. Thus the par of the British pound sterling is \$4.8665, which means that one pound sterling is the equivalent in weight and fineness of \$4.8665. However, exchange is not quoted at a premium above or a discount below par. Exchange on London, Denmark, Holland, Norway, Sweden and Spain is usually quoted at the value of the foreign standard coin in the United States money. Exchange on France, Belgium, Italy and Switzerland is usually quoted at the value of a dollar in the foreign coinage. Thus, if it is desired to remit \$1,000 to London when exchange is 4.89½, it is necessary to find how many pounds sterling at 4.89½ will be equal to \$1,000, which is done by dividing 1,000 by 4.895, obtaining the quotient 204.29, or £204.29. To reduce the decimal .29, multiply by 20, the number of shillings in the pound. This gives 5.8 shillings. To reduce the decimal .8, multiply by 12, the number of pence in a shilling. This gives 9.6 pence, the nearest coin value of which is 9½ pence. The value of \$1,000 in sterling at 4.89½ is £204 5s. 9½d.

The reverse process will reduce sterling to dollars. If it is desired to know how many dollars are needed to buy £204. 5s. 9½d. at 4.89½, reduce the shillings and pence to decimals of a pound.

$$9\frac{1}{2} \div 12 \text{ (number of pence in a shilling)} = .8 \text{ shilling.}$$

$$5.8 \div 20 \text{ (number of shillings in a pound)} = .29 \text{ pound.}$$

Replacing 5s. 9½d. by the equivalent decimal of a pound,

$$£204.29 \times 4.895 = \$999.9995, \text{ or } \$1,000.$$

Converting values when the basis is the number of foreign coins to the dollar requires an exactly opposite procedure. The process is not as complicated as in the case of sterling because all the countries involved

Students' Department

use the decimal system in their coinage. The par value of the franc or lira (Italian) is 19.3 cents, or 5.1813 francs or lire to the dollar.

If it is required to find the cost of a draft on Antwerp for 1,000 francs when exchange is quoted at 5.19¾, it is evident that if 5.19¾ fr. are worth \$1, 1,000 fr. will be worth as many dollars as 5.19¾ is contained in 1,000. Therefore $1,000 \div 5.1975 = 192.40$, the required cost in dollars.

To find how many francs a given amount in dollars will purchase at a given rate of exchange, multiply the amount in dollars by the value in francs of one dollar. Thus, to find how large a draft in Paris can be bought for \$192.40 when exchange is at 5.19¾, multiply 192.40 by 5.1975.

The process of computing the cost of exchange between two places by means of one or more intermediate exchanges is called the arbitrage of exchange. The object of using an intermediate exchange is to take advantage of variations in rates between different places. It is adopted when the rate of direct exchange is unfavorable.

To illustrate, a New York concern wishes to transfer \$10,000 to its agent in Paris. The New York rate for francs is 5.25¼. Sterling may be bought in New York for 4.84½, and the rate between London and Paris is 25.73 francs to the pound sterling. Is it better to remit direct to Paris or to remit sterling to the agent in London with instructions for him to remit to the Paris agent?

If the \$10,000 is used to buy a direct draft on Paris at 5.25¼, it will realize 52,525 francs. With sterling at 4.84½, \$10,000 will buy £2,063.98 ($10,000 \div 4.845$). It is not necessary to reduce the decimal to shillings and pence. Multiplying 2,063.98 by 25.73, the number of francs in a pound, gives 53,162.05, the number of francs obtained. The Paris agent will therefore receive 637.05 francs more if the money is sent through London than if it is sent direct.

Unless there is some way to guarantee the rate between London and Paris this comparison can be made only on cable transfers. When the margin is not very large a slight change in the London-Paris rate might change a profit into a loss, during the time it would take to send a draft to London by mail.

Banks or brokers dealing in foreign exchange keep their accounts in one of two ways. The first, which is the usual method in the United States, resembles a single merchandise account with a running inventory, to which purchases are debited and sales credited both in quantities and values. At the closing date the balance in foreign currency is inventoried at the current rate, giving consideration to the various portions of the balance which are subject to cable transfers, to cheques and to time drafts. The United States money column is then balanced by an offsetting debit or credit to exchange, according to whether a loss or profit has been made.

An example will make this clearer. A dealer in sterling exchange had these entries during a certain month:

Bought at 4.858	£1,000	0	0	\$4,858.00	Sold at 4.875	£100	0	0	\$487.50
Bought at 4.86	500	0	0	2,430.00	Sold at 4.90	10	0	0	49.00
Interest allowed	2	10	0		Sold at 4.8675	600	0	0	2,920.50
Profit, cr. exch.				22.53	Balance	792	10	0	3,853.53
	1,502	10	0	7,310.53		1,502	10	0	7,310.53
	1,502	10	0	7,310.53		1,502	10	0	7,310.53

The Journal of Accountancy

The drafts bought and sold are recorded in both currencies, the interest allowed is charged in sterling only, as it is only the sterling balance that is affected. If the English bank had charged any commissions, interest or other expenses, the account would have contained a credit for them in sterling only. When the sterling balance is struck it is inserted in both currencies at the current rate for the day. The sterling columns will now balance. The amount necessary to balance the dollars is entered in the dollar column only, the offsetting entry being a debit or credit to exchange.

It is to be noted that part of the above profit is due to the interest allowed by the English bank. This might be credited to interest and charged in the dollar column at $4.86\frac{1}{4}$ (the current rate used for conversion of the balance of the account) or \$12.16, reducing the credit to exchange at \$10.37. Another complication arises when the drafts bought and sold are drawn at some time after sight, since interest to maturity will have to be taken into consideration in fixing the value of the balance.

The second method of carrying a foreign-exchange account reduces all values to the par of exchange, the difference between par and the actual price being treated as a debit or credit to exchange. This necessitates a debit and a credit column in the purchase register and in the sales register and also a par column in each. The purchase register would show:

Name	Draft	Price	Par	Dr. exchange	Cr. exchange
—	£1,000 0 0	\$4,858.00	\$4,866.50	....	8.50
—	500 0 0	2,430.00	2,433.25	....	3.25

The sales register would show:

—	£ 100 0 0	\$ 487.50	\$ 486.65	....	.85
—	10 0 0	49.00	48.66	....	.34
—	600 0 0	2,920.50	2,919.90	....	.60

The ledger account would contain the purchases and sales at par, and the balance would be brought down at par, the interest having been entered in the dollar column also at \$12.16 and credited at that amount. This would indicate the following profit:

On purchases	11.75
On sales	1.79
For interest	12.16
	25.70
Total	25.70
Less apparent loss on balance of £792 10 0	
Value at par	3,856.70
“ “ market	3,853.53
	3.17
Net profit (as before)	22.53

When inhabitants of a gold-standard country invest money in branches in a country whose coinage is on a silver or paper money basis, the variations in the rate of exchange are apt to be very wide from time to time. The owners of the property must keep their accounts in gold values, while the foreign managers are obliged to keep theirs in the currency of the

Students' Department

country in which operations are conducted. If the enterprise is in a silver country and the home office is in the United States, the manager at the property must make his periodical reports in his local silver currency. When these reach the home office they must be converted into gold values at the rate that will express as nearly as possible the true condition of affairs. In order to ascertain the correct procedure it is necessary to analyze the conditions.

When the enterprise is started, the first steps will be the purchase of land, the construction of buildings and the purchase and installation of machinery. The purchase of the land and the erection of buildings will probably be paid for in silver currency. The money sent from the United States will be charged to land and buildings by the home office at the gold value of the drafts sent. The local manager will credit the home office with the silver value he receives and will charge land and buildings on the silver basis when he pays out the money. Machinery may be sent from this country. The cost including the freight would be charged to machinery by the home office at the gold value of the money expended. If the local manager put it on his books he would charge machinery and credit home office at the current rate of exchange. The money sent for the labor and other expense of installation would be charged by the home office in gold and by the manager in silver at the rates actually paid. When construction is finished, the total cost of the fixed assets is recorded in one place in gold and in the other in silver. These relative values are never changed, except as new fixed assets are added at the rate of exchange then current. In consolidating the home office and branch balance-sheets, the fixed assets at the branch would be taken up at the dollar values shown on the home-office books. Hence it is not necessary that the branch continue to carry the fixed assets at their cost in the local silver currency, and the fixed-asset accounts may be closed by a charge to the home-office account. If it is desired to continue to carry the fixed assets on the branch books as well as on the home-office books, it would be desirable to divide the home-office account on the branch books by setting up a home-office account for fixed assets and a home-office current account.

When the enterprise reaches the operating stage, the home office will be obliged to send money with which to carry on the business. This should be charged to a current account with the foreign branch, and not to the previous construction or capital account. The home office should keep this current account in both currencies, in silver in an inside set of debit and credit columns and in gold in the regular account columns. The silver debits will be the amount of the draft remitted by the home office, if that draft is drawn direct on the silver country, or the proceeds of a gold draft when the latter is sold by the manager of the plant.

Periodically the manager of the plant should render a report in which he should credit the home office with the silver value of the money received from it and should charge the home office with all his expenditures in silver, properly classified for statistical purposes. The home office should credit the current account in the inside column at the silver value actually expended and at the gold value of the remittances made, beginning with the first remittance at the rate shown on the debit side and then taking

The Journal of Accountancy

up in turn the subsequent remittances. In this way the actual amount paid both in silver and in gold will be reflected in the accounts.

If the home office buys for gold and ships to the plant any raw materials or supplies that are not immediately used, it should charge and the plant should credit the silver value at the rate of exchange at the time of shipment. As the articles are used, it would seem the proper procedure to charge them to operating costs at the same rate. However, Sir A. Lowes Dickinson says, "The most satisfactory method of dealing with this condition is to keep the accounts of materials, stores and supplies originating in the United States in United States currency until they are used, and then to charge them out to the accounts concerned—whether construction or operating—at the rate of exchange current on the date of issue for consumption; in other words, these materials, etc., while in fact in China, are deemed to be in the United States until issued for consumption, and are only then passed through the current accounts between the two offices."

This is open to the objection that the accounts at the plant will not reflect the true conditions, as the plant may be in possession of a large amount of materials, etc., which will not appear on its books until used, and to the further objection that, if the materials are issued very frequently, the rate at which they must be charged to operations by the branch manager will be subject to constant variation with regard to actual cost, and that no silver value can be expressed on the home-office books until the report of the dates and quantities of the different issues is received in the United States.

When any finished products are shipped from the plant to the home office, they should be charged at cost in silver. The home office should credit them at the same figure in the silver column and at the current rate of exchange in the gold column.

At the close of the fiscal period, when the books are closed, no change is made in the debit balances of the fixed-asset accounts because of the established principle that fixed assets should be valued at cost, regardless of market fluctuations. In regard to the floating assets and liabilities, the custom is to convert the values at the rate of exchange current on the day of closing. There is considerable variation in the procedure for the valuation of nominal account balances—sometimes they are converted at an average rate for the period, and sometimes at the current rate at the end of the period. While the average-rate method is usually advocated on the ground that the earnings and expenses accrued during the period, this method is subject to the objection that a simple average of the rates of all days during the period fails to take into consideration the fact that transactions varied in volume from day to day. As the operations resulted in an increase or decrease of the net current assets at the branch and since these current assets and current liabilities are converted at the rate current at the end of the period, it would seem consistent to convert the current-account balances at the same rate.

The following example will illustrate the procedure of closing branch and home-office books and consolidating the revenue statements and balance-sheets.

Students' Department

PROBLEM

The trial balance of the London branch of the Eastern and Western Manufacturing Co. at December 31, 1919, follows:

Home-office current account		£ 54,000
Remittance account	£ 60,000	
Cash	7,000	
Accounts receivable	3,000	
Merchandise inventory, Jan. 1, 1919	4,000	
Merchandise from home office	50,000	
Expenses	5,000	
Sales		75,000
Accounts payable		1,000
Furniture and fixtures	1,000	
	£ 130,000	£ 130,000
	£ 130,000	£ 130,000

Inventory, December 31, 1919, £5,000.

The rate of exchange current at the date of purchasing the furniture and fixtures was 4.83.

The current rate at January 1, 1919, was 4.64.

The average rate for the year was 4.65.

The current rate at December 31, 1919, was 4.665.

The trial balance at the same date drawn from the books of the home office was:

Capital stock		\$ 75,000.00
Factory land	\$ 10,000.00	
Factory building	40,000.00	
Raw material	30,000.00	
Purchases—raw material	450,000.00	
Goods in process, January 1, 1919	15,000.00	
Finished goods, January 1, 1919	8,000.00	
Productive labor	350,000.00	
Manufacturing expense	180,000.00	
Selling expense	20,000.00	
General expense	9,000.00	
Accounts receivable	12,265.00	
Cash	31,000.00	
Accounts payable		18,000.00
Reserve for depreciation—factory building		2,000.00
London branch current account	249,750.00	
Reserve for depreciation—London furniture and fixtures		500.00
Shipments to London branch		232,500.00
Sales		780,000.00
Remittances from London branch		279,000.00
Reserve for exchange fluctuations		2,515.00
Surplus		15,500.00
	\$1,405,015.00	\$1,405,015.00
	\$1,405,015.00	\$1,405,015.00

The Journal of Accountancy

Home-office inventories, December 31, 1919:

Raw materials	\$35,000.00
Goods in process	13,000.00
Finished goods	16,000.00

Prepare:

- (a) Closing entries on the branch books.
- (b) Balance-sheet of branch after closing.
- (c) Statement converting branch trial balance and December 31, 1919, inventory to the dollar values at which the various items should appear in the closing entries which will be made to take up the branch profit on the home-office books and in the branch balance-sheet consolidated with the home-office balance-sheet.
- (d) Branch profit-and-loss statement for the year, from facts shown on the branch books, shown in pounds sterling and in dollars.
- (e) Journal entries on the home-office books taking up the branch profit shown in the statement required in (d).
- (f) Journal entries closing the home-office books, allowing \$1,000.00 depreciation on the factory buildings and \$500.00 depreciation on the furniture and fixtures of the branch.
- (g) Statement of the London branch current account on the home-office books.
- (h) Branch balance-sheet in pounds sterling and dollars, showing dollar balance of home-office current account in agreement with branch current account balance in (g).
- (i) Working papers consolidating the branch and home-office balance-sheets.
- (j) When the average rate is not known or is not to be used for nominal account conversions, the various conversions are made as follows:
 - Fixed assets at the rate current at the time of purchase.
 - Current assets and liabilities at current rate.
 - Opening inventory at rate at beginning of period.
 - Shipments from home office at balance of shipments account on home-office books.
 - Nominal accounts at current rate.Prepare the following assuming that the average rate is not known:
 - Journal entry on home-office books taking up net profit shown by branch books.
 - Journal entry adjusting the branch current account and reserve for exchange.
- (k) Assume that the home office does not keep a reserve for exchange, but absorbs the adjustment in the branch profit and loss account—show how the last entry under (j) would be made in that case, and draw up the branch profit and loss account as it would appear on the home-office books.

Students' Department

SOLUTION

(a) Closing entries on branch books.

Sales	£75,000	
Merchandise inventory, Dec. 31, 1919	5,000	
Profit and loss		£80,000
To set up inventory and close sales account		
Profit and loss	59,000	
Merchandise inventory, Jan. 1, 1919		4,000
Merchandise from home office		50,000
Expenses		5,000
To close merchandise cost and expense accounts		
Profit and loss	21,000	
Home-office current account		21,000
To close out net profit		
Home-office current account	60,000	
Remittance account		60,000
To close remittance account		

(b) EASTERN & WESTERN MANUFACTURING CO., LONDON BRANCH

Balance-Sheet—December 31, 1919

ASSETS		LIABILITIES	
Cash	£ 7,000	Accounts payable	£ 1,000
Accounts receivable	3,000	Home-office current	15,000
Merchandise inventory ...	5,000		
Furniture and fixtures ...	1,000		
	£16,000		£16,000
	£16,000		£16,000

(c) *Statement of Conversion of Branch Trial Balance*

	£	£	Rate	\$	\$
Home-office current		54,000			
					Not converted—contra acct. on home-office books
Remittance account.	60,000				
					Not converted—contra acct. on home-office books
Cash	7,000		4.665	32,655.00	
Accounts receivable.	3,000		4.665	13,995.00	
Merc'dise inv. Jan. 1	4,000		4.64	18,560.00	
Merc'dise from h. o.	50,000		h. o. contra	232,500.00	
Expenses	5,000		4.65	23,250.00	
Sales		75,000	4.65		348,750.00
Accounts payable ..		1,000	4.665		4,665.00
Furniture and fixtures	1,000		4.83	4,830.00	
	130,000	130,000			
	130,000	130,000			

Inventory, December 31, 1919, £5,000 @ 4.665 = \$23,325.00

The Journal of Accountancy

(d) EASTERN & WESTERN MANUFACTURING CO., LONDON BRANCH
Profit and Loss Statement—Year Ending December 31, 1919

	Pounds sterling	Dollars
Sales	75,000	348,750.00
Deduct cost of goods sold:		
Inventory	4,000	18,560.00
Merchandise from home office. 50,000	50,000	232,500.00
Total	54,000	251,060.00
Less inventory Dec. 31	5,000	23,325.00
	49,000	227,735.00
<i>Gross profit on sales</i>	26,000	121,015.00
Deduct expenses	5,000	23,250.00
	21,000	97,765.00
<i>Net profit</i> (subject to depreciation)	21,000	97,765.00

(e) Journal entries on home-office books taking up branch net profit.
 London branch current account 97,765.00
 London branch profit-and-loss-account 274,310.00
 London branch profit-and-loss account 372,075

To credit branch profit and loss with:

Sales	£ 75,000 @ 4.65	348,750
Inventory Dec. 31	5,000 @ 4.665	23,325
Total credits		372,075

To debit branch profit and loss with:

Inventory Jan. 1	£ 4,000 @ 4.64	18,560
Mdse. from h. o.	50,000 @ h. o. bal.	232,500
Expenses	5,000 @ 4.65	23,250
Total debits		274,310

To charge current account with profit

97,765

(f) Journal entries closing home-office books.

London branch profit and loss account	500.00	
Reserve for dep'n, London furniture and fixtures		500.00
To provide one year's depreciation		
Shipments to London branch	232,500.00	
Manufacturing account		232,500.00
To close shipments account		
Raw material inventory	35,000.00	
Purchases—raw material		35,000.00
To set up December 31 inventory		

Students' Department

Purchases	30,000.00	
Raw material inventory, Jan. 1		30,000.00
To close Jan. 1 inventory		
<hr style="width: 20%; margin: 0 auto;"/>		
Manufacturing account .....	.991,000.00	
Goods in process, Jan. 1		15,000.00
Purchases—raw material		445,000.00
Productive labor		350,000.00
Manufacturing expense		180,000.00
Reserve for depreciation, factory building		1,000.00
To set up costs of manufacture		
<hr style="width: 20%; margin: 0 auto;"/>		
Goods-in-process inventory	13,000.00	
Manufacturing account		13,000.00
To set up inventory, Dec. 31		
<hr style="width: 20%; margin: 0 auto;"/>		
Selling account .....	.773,500.00	
Manufacturing account		745,500.00
Finished goods, Jan. 1		8,000.00
Selling expense		20,000.00
To charge selling with finished goods and expenses		
<hr style="width: 20%; margin: 0 auto;"/>		
Finished goods inventory	16,000.00	
Sales .....	.780,000.00	
Selling account		796,000.00
To put present inventory on books, crediting selling account therewith, and closing sales to selling account		
<hr style="width: 20%; margin: 0 auto;"/>		
Selling account	22,500.00	
Profit and loss		22,500.00
To close net profit on sales to profit and loss		
<hr style="width: 20%; margin: 0 auto;"/>		
Profit and loss	9,000.00	
General expense		9,000.00
To close general expense account		
<hr style="width: 20%; margin: 0 auto;"/>		
Profit and loss	13,500.00	
London branch profit and loss .....	.97,265.00	
Surplus		110,765.00
To close home office and branch profits to surplus		
<hr style="width: 20%; margin: 0 auto;"/>		
London branch current account	1,625.00	
Reserve for exchange fluctuations		1,625.00
Entry to raise current account balance representing net assets at branch to net conversion values.		
<hr style="width: 20%; margin: 0 auto;"/>		
Remittances from London branch .....	.279,000.00	
London branch—current account		279,000.00
To close remittance account to current account		

The Journal of Accountancy

(g) *Statement of London Branch Current Account*

January 1, 1919, to December 31, 1919

Balance, January 1, 1919	249,750.00
Add branch profit for the year as shown by branch books, but before providing depreciation on furniture and fixtures	97,765.00
 Total	347,515.00
Deduct remittances	279,000.00
 Balance before exchange adjustment	68,515.00
Add charge to current account and credit to reserve to reconcile current account with branch balance-sheet at conversion values	1,625.00
 Balance, December 31, 1919	70,140.00

(h) *EASTERN & WESTERN MANUFACTURING Co., LONDON BRANCH*

Balance-Sheet—December 31, 1919

ASSETS

	£	Rate	\$
Cash	7,000	4.665	32,655.00
Accounts receivable	3,000	4.665	13,995.00
Merchandise inventory	5,000	4.665	23,325.00
Furniture and fixtures	1,000	4.83	4,830.00
	16,000		74,805.00
	16,000		74,805.00

LIABILITIES

Accounts payable	1,000	4.665	4,665.00
Home-office current account	15,000	(To balance)	70,140.00
	16,000		74,805.00
	16,000		74,805.00

(i) *EASTERN & WESTERN MANUFACTURING COMPANY*

Consolidated Balance-Sheet Working Papers—December 31, 1919

ASSETS

	Home office	Branch	Eliminations	Consolid'd
Factory land	10,000	.....	.....	10,000
Factory buildings	40,000	.....	.....	40,000
Raw materials	35,000	.....	.....	35,000
Goods in process	13,000	.....	.....	13,000
Finished goods	16,000	23,325	.....	39,325
Accounts receivable	12,265	13,995	.....	26,260
London branch current ...	70,140	.....	70,140	.....
Cash	31,000	32,655	.....	.....
Furniture and fixtures ...	.....	4,830	.....	4,830
	227,405	74,805	70,140	232,070
	227,405	74,805	70,140	232,070

Students' Department

LIABILITIES

Capital stock	75,000	.....	.....	75,000
Accounts payable	18,000	4,665	.....	22,665
Reserve, dep'n. bldgs.	3,000	.....	.....	3,000
Reserve, dep'n. furniture and fixtures	1,000	.....	.....	1,000
Reserve for exchange	4,140	.....	.....	4,140
Surplus	126,265	.....	.....	126,265
Home-office current .....	.....	70,140	70,140	.....
	<u>227,405</u>	<u>74,805</u>	<u>70,140</u>	<u>232,070</u>

(j) Journal entries on home-office books taking up branch net profit, when nominal account balances are converted at current instead of average rates:

London branch current account	98,815.00	
London branch profit and loss account	274,385.00	
London branch profit and loss account.....		373,200.00
To credit branch profit and loss with:		
Sales £ 75,000 @ 4.665	349,875	
Inventory Dec. 31 5,000 @ 4.665	<u>23,325</u>	
Total	<u>373,200</u>	
To charge branch profit and loss with:		
Inventory Jan. 1. £ 4,000 @ 4.64	18,560	
Mdse. from h. o. 50,000 @ h. o. bal.	232,500	
Expenses 5,000 @ 4.665	<u>23,325</u>	
Total	<u>274,385</u>	
To charge branch current with profit	<u>98,815</u>	

The current account on the home-office books would now stand:

Balance before closing (per trial balance)	249,750.00
Add profit	<u>98,815.00</u>
Total debits	348,565.00
Less remittances	<u>279,000.00</u>
Balance	<u>69,565.00</u>
London branch current account	575.00
Reserve for exchange fluctuations	575.00
To raise current account balance to conversion value of net assets at branch.	

When a reserve for exchange is kept it is on the theory that the apparent profit represented by the exchange adjustment may be apparent only and

The Journal of Accountancy

that it may be reduced or wiped out by future adjustments when the exchange rates are not favorable. Hence instead of passing the credit through profit and loss it is thrown into a reserve where it will be available to absorb possible exchange losses in future. Assuming that no reserve is kept, the adjustment would be made as follows:

(k) Closing entry for exchange adjustment if no reserve is kept.

London branch current account	575.00
London branch profit and loss account	575.00
To adjust current account to conversion value of net assets at branch.	

London Branch Profit and Loss Account

(On home-office books)

1919	1919
Dec. 31. Inventory, Jan. 1... 18,560	Dec. 31. Sales 349,875
31. Shipments from home office 232,500	31. Inventory, Dec. 31.. 23,325
31. Expenses 23,325	
31. Profit per br. books 98,815	
373,200	373,200
31. Depreciation, fur- niture and fixtures 500	31. Profit, down 98,815
31. Net profit to surplus 98,890	31. Exchange 575
99,390	99,390

F. W. Hilditch & Co. announce the removal of their offices to 17 east 42nd street, New York.

William G. Adkins announces the removal of his Chicago office to 37 south Wabash avenue.

Waldman, Schoolman & Co. announce the removal of their offices to 511 Fifth avenue, New York.

Edward A. McAllister announces the opening of an office at 2 Rector street, New York.

William H. Willis announces the opening of an office at 1400 Broadway, New York.

Max Meyer announces the removal of his office to 253 Broadway, New York.

David B. Jacobs announces the removal of his office to 217 Broadway, New York.