



Study Of Economic Reality on Foreign Exchange Accounting

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Abstract

This study tested the gap between foreign exchange accounting treatment and the underlying economic reality, by comparing the regression model between U.S. Companies and Indonesian Companies in one particular economic period. A total sample of 139 companies, consisting of 60 companies with rupiah functional currency domiciled in Indonesia and 79 companies with dollar functional currency domiciled in the United States. The simple regression variable used is comprehensive profit as a dependent variable and foreign exchange gain and loss as an independent variable. Hypothetical conclusions are carried out by testing regression patterns on the underlying economic circumstances. The results of the statistik regression corseccion test showed significant value indicating the influence between variables on a number of companies that have a uniform pattern, conclusions are strengthened by considering the economic situation in the data retrieval situation using criteria such as currency exchange rate, GDP, trade balance and others on each country, while insignificant influence indicates the opposite. Based on the test results and economic analysis shows the results of regression that signfikan in each region with economic conditions that support fluctuations in exchange rate changes in each region. So it is concluded that there is no difference between the treatment of foreign exchange accounting and the underlying economic reality.

Keyword: Foreign Currency, Accounting exposure, Economics Reality

INTRODUCTION

Fluctuations in exchange rates have a significant impact on the economic performance of a country, the occurrence of economic crises that have an infectious effect between countries in the decades that have passed inseparable from fluctuations in the exchange rate of one country's currency with other countries. The rate of depreciation of the exchange rate determines the effect of the burden of the crisis borne by a country. (Gourinchas 2019, Saleheen Khan 2018, Mittal 2018).

In the context of microeconomics exchange rate volatility has a different impact for each company either in crisis or stable economic conditions. Research has been conducted to explain the impact of currency exchange rate changes on the company's value (Dhagat, Raju G 2016), in some cases research has also been conducted to explain the company's management efforts to mitigate the impact of exchange rate turmoil on its operations and investments by hedging transactions and investments exposed by foreign exchange fluctuations (Anuradha 2019). The

impact of foreign exchange fluctuations is the result of losses and losses arising from changes in the exchange rate on operating activities and investments related to foreign currencies in both the balance sheet and profit and loss. (FASB, 1981).

The profits and losses reported at the end of the period thus affect the value of the company. Profits and losses caused by changes in foreign exchange in general are due to two things, namely transactions made from international trade and consolidated activities of financial statements of subsidiary or branches operating abroad. Attention to the study of the impact of fluctuations in exchange rates on foreign exchange transactions, was found when companies faced exposure to the value of assets or liabilities to foreign exchange risks, which directly affected their cash flow and profitability when monetary transactions were realized. Hedging is carried out with the aim of providing protection for the purpose of protecting such transactions, or at least reducing the impact of risks, linking profits and losses on foreign exchange financial derivatives (instrument hedging) with losses and profits against items subject to foreign exchange hedging.

The impact of foreign exchange transaction activities on the company's performance is widely reviewed through the decisions taken by hedging techniques. The impact of foreign exchange fluctuations on consolidated financial statements is reviewed through the decision of the selection of translation methods that provide details of how and how much the value of the company increases and decreases in the effectiveness of foreign currencies (Collin and Salatka 1993. B so l so 1994, Louis 2003, Pisto 2005). In the context of accounting, the translation of a foreign exchange is a re-presentation of accounting data expressed in one exchange rate to another.

The content of foreign exchange translation is carried out in the recording of book accounts and preparation of individual company financial statements as well as the consolidation of subsidiaries with the parent company on the condition that they are not at the same exchange rate (Nobes and Parker, 2010). Controversy is present in both types of problems, on the profits and losses caused by the consolidation of financial statements, the accuracy of the different translation methods suggested by accounting standards, and more specifically, on the treatment resulting from the translation adjustments resulting from the consolidated financial statements. In international trade transactions involving foreign exchange the approach chosen in the accounting treatment of such transactions provides a different effectiveness in addressing the economic reality of foreign exchange fluctuations. (Choi and Meek, 2008).

The impact of foreign exchange fluctuations on the company is described in the financial statements in the form of foreign exchange gains and losses and foreign exchange adjustments. Higher fluctuations in exchange rates will increase the amount of adjustment (Eitemen, stonhill *Moffet, 2000). The translation of foreign exchange impacts in consolidated reporting is determined by appreciation and depreciation of foreign currencies, each of which has positive adjustment implications for profit translation assumptions and negative loss translation assumptions, based on assumptions of net foreign exchange exposure position between assets and liabilities (exposure to net assets or net liabilities) on the operations of subsidiaries or branches abroad. Exposure levels will differ when the selection of translation methods is different, the standard determines the selection of methods used in the translation of the impact of fluctuations in exchange rate changes.

Under the temporal method, adjustments are included in the profit and loss as a component of the net profit, which affects the valuation of profit by the market. (Beaver and wolfson, 1984). The main difference between the two forms of translation is that the translation of foreign exchange fluctuation transactions has an impact on the company's cash flow on the settlement of transactions carried out. While the translation of foreign exchange fluctuations

has no effect on the company's cash flow, losses and profits incurred are often referred to as "paper gain" or "paper loss" categories (Bartao, 1997, Bsoo* L. so 1994, Huang 1992, Pinto 2005).

In 1975, was the beginning of the issuance of the first translation accounting standard, Statement of Financial Accounting Standard (SFAS) No. 8- by the Financial Accounting Standard board (FASB) is an accounting standard for the translation of foreign exchange translation and foreign exchange financial statements intended to offset the policy of determining floating exchange rates set by the government. SFAS no. 8 sets the use of temporal and comprehensive earning concepts in adaptation behavior, which is the placement of spread adaptation in the consolidation earning.

SFAS No 8 that has been issued has not least reaped criticism by various parties, especially in the treatment of profits and losses adjustment of consolidated financial statements. (Batov, 1997, Huang,1992, Louis 2003, Selling and Sorton 1983). SFAS No. 52, published as the replacement of SFAS No 8, SFAS No. 52 is issued with the main difference are the use of the current exchange rate and the and the elimination of the translation adjustment of the profit and loss.

The temporal method is still requested by SFAS no. 52 in cases when the U.S. dollar is used as the functional exchange rate of a subsidiary in a case when the subsidiary is located in a hyperinflation economy. The decision of the currency which is a functional currency depends on the management of the company.

Choi and G Meek (2008), gave an argument to describe the level of problem in the translation of foreign exchange, writing metaphorically that "If foreign exchange rates are relatively stable, the process of elaborating on exchange rates will not be more difficult than describing inch and feet in metric equivalent.". The absence of a fixed exchange rate, makes the accountant must deal with two issues, which type of exchange rate (historical or current) is used in describing assets and liabilities denominated in foreign exchange rates. How profits and losses arising from changes in exchange rates are treated in an accounting context.

An important issue is: Whether the translation of exchange rate adjustments has provided information consistent with economic reality, whether the positive/negative translation adjustment is related to the increase or decrease in the value of the company. Louis (2003) analyzed adjustments to the translation of exchange rate fluctuations in financial statements by comparing the generally accepted eonomi theory point of view with the effect of accounting treatment on exchange rate fluctuation. Louis's analysis (2003) concluded that local exchange rate depreciation caused: (1) adjustment of negative translation (accounting influence) and (2) increase in the value of overseas operations (economic influence). By using samples of manufacturing companies. Louis Also concluded that accounting rules governing the translation of foreign exchange rates generally create the opposite effect on the economic influence of changes in exchange rates (Louis, 2003, Pinto 2005).

Based on the description presented earlier the author emphasized on the problem of accuracy of method selection and assessment reporting the impact of changes in foreign exchange rates on the company's finances, especially on profit, so that this study will identify differences if any, economic reality with accounting treatment of foreign exchange rates.

THEORETICAL FRAMEWORK AND HYPOTHESIS

Changes in Exchange Rates and Companies

Variations in exchange rates have a significant influence on the value of the company, increased volatitility of the exchange rate negatively affects the return of shares, multinational companies experience a greater influence of foreign exchange exposure compared to domestic

companies, so that the influence of depreciation and appreciation of the exchange rate has a significant impact that varies between companies. Dhagat and Raju (2016) found that variations in stock return rates can be explained by the rate of exchange rate change.

Market capitalization using a company size proxy, has a significant influence in determining the exposure of exchange rates. Jasmina et.al (2016) Testing transaction exposure in companies operating internationally, differences in exposure management options against existing exposure types based on the volume of corporate exchange transactions. His research found that companies in Serbia did not have a measure of protection against negative exposure to their cash flow and profitability, and also found that exposure management practices were influenced by factors other than the level of foreign exchange transactions such as the company's national origin.

Anuradha (2019) conducted a study of the types of foreign exchange risks faced by companies in line with the development of trade between countries. His paper further describes risk management strategies with a primary preference for hedging and a variety of hedging strategies used both internally and externally in multinational companies.

Mouradian (2017) in his research gathered evidence of the influence of currency fluctuations on operating cash flow and mitigated product and production strategies to respond to the economic consequences of exchange rate changes on operating profit. Rashmi (2018) in his study found a strong negative influence of exchange rate appreciation and volatility on the capital markets of IT companies in India.

Hao Li et al (2014) sought to provide an perspective on the hedging benefit debate by conferring the conclusion that the use of derivative currencies does not affect the value of the company. The study was conducted at a non-financial company in New Zealand. Jasmina (2013) in his research discussed aspects of accounting for the translation of foreign exchange transactions, exposure of company transactions to currency risk, and the use of derivative instruments for hedging against foreign exchange risks.

Nobes and Parker, (2010) explain the specific meaning of the word translation and its difference with foreign exchange conversion the accounting context of foreign exchange transactions is a process of expression of financial data in one currency into another using the specified exchange rate. The current historical rate, or average can be used in the process of monetary expression. From changes in foreign exchange denominations to domestic equivalent exchange rates, while conversion is a real implication, exchange, physical exchange, from one exchange rate to another. Accountants use the description of foreign exchange transactions aimed at meeting the homogeneity of financial exchange rate data.

Based on other views foreign exchange transactions are broken down into real and monetary segments, and purchases or sales on one side and settlements and obligations or billing on the other hand, are treated separately. The difference between the initial recorded amount on the transaction date and the amount at the close of the transaction is treated as profit and loss to foreign exchange transactions (profit and loss of the transaction). By comparing these points of view, it can be concluded that both have an influence on profitability in the same way (Allen, Svetlana 2012).

Changes in Exchange Rates and Economic reality

Mittal (2018) found that uniform currency in Southeast Asia could not be applied. Macroeconomic convergence is underway, which is the basis for greater economic cooperation. Khan (2018) in his research provides support that trading provides an important role in explaining the strength of the exchange crisis, in addition to macroeconomic fundamentals and capital market dynamics. Gourinchas (2019) in his research explains the role of the dollar for

international trade and international financial transactions, the implications for decision makers "in the world of dollars".

Basirat (2014) Examines the Effect of exchange rate fluctuations on economic growth taking into account the development of money markets in developing countries. The results obtained show the influence of financial developments on economic growth and exchange rate fluctuations on economic growth is negative and significant. Kandil, (2004) tested the effect of fluctuations on real output growth and price inflation in developing countries, analysis was carried out by dividing the movement of exchange rate changes into two components, namely anticipated and unanticipated components.

The model shows the effect of demand and supply on output and price responses to exchange rate changes. In general, depreciation of exchange rate changes, whether anticipated or not, decreases real output growth and increases price inflation. Confirmation of evidence relating to the negative influence of exchange rate depreciation in economic performance in developing countries.

Gopinath (2015), looking for empirical evidence for the International Pricing System, in global trade in developed and developing countries. This pricing system is characterized by two features. First, world trade occurs using a small amount of exchange rates, with the dollar as the dominant exchange rate. Both international prices that use their own exchange rates, are not very sensitive to changes in exchange rates. In this system the proxy sensitivity to changes in exchange rate fluctuations is part of imports made on foreign currencies.

Changes in depreciation rates (appreciation) make American exports cheaper (expensive), while for other countries increase (lower) mark-ups and increase profits. American monetary policy has a "Spillover" effect on inflation in other countries, while spillover influence from other countries does not exert sufficient influence

Hypothesis

Exposure to exchange rate risk is a measurement of changes in profitability, cash flow, and market value of companies caused by changes in exchange rates (Saudagaran, 2004). Shapiro, (2006) claimed exposure to the components of transactions, operations and translation, classifying is a reflection of foreign exchange risk from a diverse perspective, with the level of suitability received among others. Diversity of perspectives arises from the diversity of economic influences that have an impact on accounting activities and reporting on posts exposed to such exchange rate fluctuations.

It becomes important if the exposure is identified separately. Not only does this type affect the position and prospects of financial statements and their profitability in different ways, but these types cause differences in hedging strategies. Controversy develops in the debate of business objectives - hedging efforts against the risk of foreign exchange fluctuations, hedging is naturally intended to reduce the risk of foreign exchange fluctuations in some cases hedging is used as an effort to create profits and losses (Anuradha 2019).

The difference in exposure level is determined by the policy of choosing the translation method and the selection of accounting treatment approach offered by each country's accounting standards. There are several options of methods offered such as the current method and temporal method to determine which exchange rate is used in the process of elaborating on the exchange rate exposé in the consolidated statements (Nobes and Parker, 2010). Approach of one or two transactions, delay and recognition of profit and loss in the period between balance sheets on exposure to foreign exchange transactions.

The accuracy of the selection of methods and approaches is still a debate among practitioners and academics. Debate arises on the issue, among others, whether profits and losses are recognized when the settlement of transactions has been carried out or on the date of the balance sheet of exchange rate selection in the process of translation on each post balance sheet and profit and loss with each giving arguments about the presentation of economic reality underlying the recording of transactions from foreign exchange fluctuations The term "paper gain" or "paper loss" is an indicator of open debate in this issue Bartao, 1997, Bsoo* L. so 1994, Huang 1992, Pinto 2005).

The dollar's hegemony continues at an unpredictable time, making economic activity in international trade dominated by the dollar. The U.S.-based multinational company has the ease of expanding its business internationally supported by the dollar's dominance until the end of this decade(Khan, 2018, Gourinchas. 2019, Kandil. 2004, Kandil, 2004). Global economic pressures, on the other hand, have a volatile impact on the dollar. Economic reflections in financial statements have thus become a controversial issue until the end of the decade. (Gopinath, 2015), The influence of "Spillover" provides the basis for a discussion of why companies in America are a comparison for Indonesian companies in this study, althoughThe influence of "Spillover" has no effect otherwise. Thus the hypotheses in this study is:

"There is a difference between the treatment of foreign exchange accounting and the reality of Economic"

RESEARCH METHOD

Research Design

This research was conducted using descriptive inferential method with simple cross section statistic regression test against hypothesis by using secondary data in the form of financial statements from two countries. Conclusions will be drawn after statistical processing data provides significance information. The purpose of the research is exploratory which is useful for further research to determine the specifications of the problem in more detail.

Population and Sample

The research was conducted on companies of various sectors listing on the capital market in Indonesia and the United States. The company was selected as a sample based on the reporting functional currencies, namely rupiah functional currencies and dollar functional currencies. At one period by crossection method. In detail, purposive sampling is as follows:

1. The Company provides information on foreign exchange differences in its profit and loss statements.
2. Companies with functional currencies Rupiah and Dollar
3. The company is registered in the Indonesian and U.S. capital markets.

Data Analysis Method

Data is processed using simple OLS regression, to determine the relationship between foreign exchange gains and losses to profit and crossection data, on the whole of both samples and in each by regressing on the whole and in each functional sample. Sample selection is conducted to observe the behavior or tendency of accounting treatment individually or jointly - equally to the influence of exchange rate changes in the same situation. Conclusions are drawn whether there are differences in behavior arising in each accounting treatment.

LC = a + b1 Vrt1

$$LC = a + b1 Vrp \dots\dots\dots 2$$

$$LC = a + b1 Vr\$ \dots\dots\dots 3$$

Source: (Ghozali, 2016)

Description.

LC = Comprehensive Profit

A = constant

B = Coefficient

Vrt = Total foreign exchange loss gain

Vrp = Foreign Exchange Gains and Losses

Vr\$ = Dollar Foreign Exchange Gains and Losses.

Conclusions will be drawn based on the results of regression with the following alternatives: If the regression result has a significant influence on the entire regression model then it is concluded that the accounting treatment is no different from the underlying economic reality. If all regression models have no effect, it is concluded that there are differences in accounting treatment with the underlying economic reality. If one or two models are influential, then the differences are concluded by further study of the economic situation in each region.

RESULTS AND DISCUSSION

Economic Situation in 2017

United States

In 2017 there was an increase in the economy with a Gross Domestic Product (GDP) value of 59,774 with growth of 2.2 with relatively stagnant economic structure growth from the previous year, there was no change in trade desfisit to 2.3 dominated by imports of goods. Increased direct investment outflows and decreased direct investment inflows (OECD 2018). Until the end of 2017 the dollar exchange index against several exchange rates experienced a strengthening (Fed Reserve).

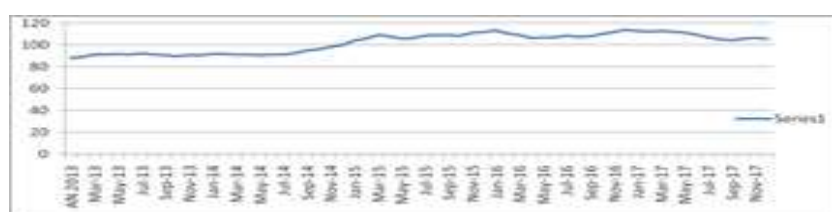


Figure 1. Dollar index movement

Source: Fed Reserve

Indonesia

In 2017 there was an increase in the economy with a Gross Domestic Product (GDP) value of 12,382 with a growth rate of 5.1 with relatively stagnant economic structure growth from the previous year, decreasing the trade deficit to 1.7 caused by increased exports of goods. Increased direct investment inflows and decreased direct investment outflows. There was an increase in purchasing power but a decrease in the exchange rate against the dollar although not insignificant at the exchange rate of 13,380. Rupiah movements against the dollar were quite volatile in 2017 with a sharp decline occurring at the end of the quarter (OECD

2018). Rupiah movements against the dollar were quite volatile in 2017 with a decrease in the occurred at the end of the www.x-rates.com.

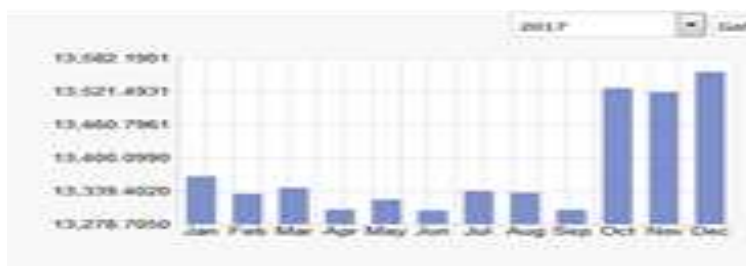


Figure 2. Rupiah's movement against the dollar

Source: www.x-rates.com

Descriptive Statistics

The total sample number of 139 companies each 60 companies with rupiah functional currency domiciled in Indonesia and 79 companies with dollar functional currency domiciled in the United States

Table 1. Descriptive Statistics of Corporate America.

	FE	NE
Min	-43.070	-73.043
Max	97.500	95.700
Mean	7.939	31.638
Stdev	16.996	31.231.

Source: Author process data

At the end of 2017, based on a sample selected by the American company, the highest profit was \$97,500 and the lowest loss booked was \$-73,043, with a profit value of \$31,638 at the mean position, and a standard deviation of \$31,231. This indicates that The American company posted a profit of mostly in the range of \$31,231. The value of the booked loss was \$-43,070 and the highest profit booked was \$97,500 . With a mean position of \$7,939 standard deviation of \$16,996. The American company posted a transaction impact and foreign exchange volatility at a profit of \$7,939 with a spread of \$16,996. The impact of foreign exchange rates on companies is quite significant, this is in line with the conditions of economic development in 2017 and the character of American companies that tend to expand their operations abroad, so that contact with foreign currencies is more frequent and does not cover the possibility of significant amounts.

Table 2. Descriptive Statistics of Indonesian Companies

	FE	NE
min	-6.85	-2.120
max	8.50	7.130
mean	-3.29	3.750
stdev	4.39	2.130

Source: Author process data

The Indonesian company in this sample posted the highest loss (in billions) of Rp2,120 with a maximum profit of Rp7,130, with a range of Rp.3,750 at 2,130 spread. Foreign exchange influence is recorded by recording a maximum loss of Rp6.85 and a maximum profit of Rp8.50, in the range of loss of Rp3.29 with a spread of Rp4.39. Mean on the value of profit in Indonesian companies shows most companies dominate the profit record. This recognition of profit is quite related to economic conditions in 2017 (OECD 2018). Bookkeeping losses with a maximum of Rp6.85 in the range of losses of Rp3.29 indicates as a large company in Indonesia recorded losses in its financial statements. The situation of Rupiah according to www.x-rates.com that tends to weaken explains the tendency to record losses

Table 3. Descriptive Statistics of American and Indonesian Companies.

	FE	NE
min	-43.070	-163.983
max	97.500	98.150
mean	4.557	4.557
stdev	13.877	33.164

Source: Author process data

When U.S. and Indonesian corporate financial statements data are combined with dollar assumptions (indonesian financial statements in the form of tens of thousands of dollars), the maximum loss is 163, maximum profit is 98,150 in the range of 4,557 with a spread of 33,164. Foreign exchange revenue maximum of 43,070 maximum profit of 97,500 in the profit range of 4,557 with a spread of 13,877. Thus we can get an idea that the dominance of earning record occurs in both companies from the country. Although the unification of American and Indonesian corporate data is a forced step, we can draw some conclusions from this effort.

Unable to meet the normality test shows that the difference in currency is a fundamental issue here, Indonesian companies with functional currency values have a magnitude that has a different meaning to american companies that use dollars. Mean 4,557 in the profit range indicates that American companies dominate the value of profit. Although the maximum loss bookkeeping is quite high in this model, but with a mean value on profit, shows the dominance of profit bookkeeping on foreign exchange which is the impact of the strong influence of the dollar (Gourinchas. 2019, Gopinath 2015).

The trend of Indonesian companies posting losses on their foreign exchange adjustments is in contrast to the record-keeping made by American companies where profits dominate their foreign exchange books. Although weakening or strengthening the currency of a currency has double implications that are profitable and detrimental, depending on which post in the balance sheet is exposure Choi and G Meek (2008). We have gotten a glimpse of how the economic reality is accommodation by accounting.

Table 4. Model T Test

	FE	NE
min	-43.070	-163.983
max	97.500	98.150
mean	4.557	4.557
stdev	13.877	33.164

Source: Author process data

The coefficient of determination in each model gives mixed results, the company's determinant coefficient in America of 0.094 has the lowest value than model 2 in Indonesian companies of 0.51 and model three which is a combination of the two data of 0.50. The determination value provides an idea of the extent to which the variable provides an explanation to its dependent variable.

The value of comprehensive profit in American companies is thus only explained by 0.94 percent by foreign exchange profits and losses, in Indonesian companies comprehensive profit is only described by 15 percent and on the comprehensive profit combined model of 50 percent, the rest is explained by other factors not discussed in this study. Although the r value is relatively small All Models have a fairly high f value of Model 1 7983, model 2 10317 and model 3 8212, this indicates that the selection of variables has met adequate model formation criteria.

The beta value on the model shows negative values, while the other two models are positive. A negative beta value indicates that the causal relationship between an independent variable and its dependents is inversely related, the value of a comprehensive profit as a dependent variable will increase when foreign exchange adjustments are reduced and the reverse. This fact occurs only in model 2, where most of the data has foreign exchange value at a loss position.

Although the r square value on each model is relatively small, the influence of dependent variables on each model is quite significant with the values of each Model 1 (2,825), model 2 (-3,212), and model 3 (2,866). The significance of the statistical value in the model can be considered as a generalization of real activity in the data used.

The company in this case posted profits and losses with a uniform pattern. The uniform pattern in this context is macro in nature, in other words the company makes decisions driven by the macro situation. This pattern is closely related to the events behind it, namely the economic situation caused by fluctuations and volatility of foreign exchange.

The hypothesis developed was then tested with the understanding that the significance of regression value indicates the uniformity of behavior driven by an event in this case the economic situation driven by exchange rate fluctuations. Based on the results of the statistical regression test the value shows high significance, this means that the treatment of foreign exchange rates affects comprehensive profit, significance occurs in all models, so that based on the above understanding, accounting treatment on foreign currencies is in accordance with the economic situation both in the United States and Indonesia. Thus the hypothesis that states "There is a difference between accounting and economic reality" is rejected.

The company's management decision relates to the management of the impact of foreign exchange fluctuations on the company related to the company's performance and value (Dhagat and Raju 2016). The results showed that financial reporting involving foreign exchange has been conducted based on the real economic situation.

The fact of economic reality in 2017, both in Indonesia and the United States, provides an overview of the economic conditions of the two countries, among others, the recognition of losses made by Indonesian companies can be explained by the weakening situation of the rupiah in the final quarter of the period, and the recognition of foreign exchange gains explained by the strengthening value of the dollar on an index at the end of 2017. Significant earning recognition in each country is explained by the relatively good economic conditions of the previous year marked by economic improvement on several indicators, such as GDP, trade value and others.

CONCLUSIONS

Economic events or economic situations that occur become the basis of decision making, although in its reporting sometimes accountants are doubtful which later becomes a controversial issue. The controversial reporting issue of accounting treatment differences with its economic realities was chosen in this study. Based on statistical and other material test results, the study concluded there is no difference between the treatment of foreign exchange accounting and the underlying economic reality. For the next research, researcher suggest to add data from countries other than the United States and Indonesia to add comparison sources, and detail the variables of foreign exchange treatment in its testing.

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