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Covering Exchange Risks in Periods of Inflation

By A. van Oss

The currencies in the western European countries are now almost everywhere stabilized by law, and the difficulties in finance and accounting that were experienced in the period of instability no longer exist to their former extent. The effects of that period are still felt, however, and we are far from a complete adjustment to the changed conditions. But gold is again used as a measure of values and business transactions can once more be recorded everywhere in figures that have definite meaning.

When exchanges fluctuate as they did during the war and for some time after, especially when rates go down to a small fraction of parity and the man in the street sees prices go up and up, there is nothing fixed or definite in domestic money values and the results are felt throughout the entire community. All classes suffer under such conditions and benefits accrue only to a few—at the expense of the great majority. The average consumer, shopkeeper, small trader and manufacturer as well as the bigger concern all have their particular exchange problems. A clear idea of these problems will facilitate proper understanding of the resulting difficulties in the finance and accounting of the big international concerns which had to reckon with the exchanges in almost all their business transactions. The magnitude of their foreign interests compelled them to devise methods of finance and accounting whereby they could cover against the risks that had to be taken, and after much groping in the dark appropriate ways and means were found. Accordingly, after an explanation of some of the technical terms used in this article a short description will be given of the difficulties experienced by certain classes in the community, as an introduction to discussion of accounting methods which ultimately developed among the larger enterprises in their efforts to solve their own exchange problems.

PRELIMINARY EXPLANATIONS

In this article expressions like "covering the exchange risk" and "purchase or sale of currency for future delivery" or "forward sales," etc., are often used. For those readers who are not familiar with foreign-exchange terms and transactions it may be well to explain what is meant by them.

In the case of a sale or a loan entailing payments in foreign currency any fluctuation in the exchange rate will make the ultimate proceeds from the sale or from the collection of the loan higher or lower than the amount originally charged or lent. The difference constitutes an exchange profit or loss.

Such profits or losses are entirely avoidable by the simple process of selling at the same time but for future delivery the foreign currency receivable in settlement of the sale or in satisfaction of the loan. In this manner the amount receivable is fixed in terms of the domestic money values.

For instance, if a New York merchant sells a bill of goods for £1,000 collectable in 30 days, he may at the same time sell the £1,000 in the exchange market for delivery in 30 days. If the 30-days-forward selling rate is 4.85 he knows that he will realize $4,850 for his goods at the time settlement is forthcoming. He has by this advance sale excluded all chance of making an exchange profit but he has also insured against any exchange loss and confined his risks to those inherent in the ordinary business of selling his goods. In other words, he has "covered" his exchange risk.

On the other hand, when a purchase is made or any kind of liability is created in a foreign currency the way to eliminate or cover the exchange risk is to buy for future delivery the amount of foreign currency payable.

If a New York merchant buys goods for £1,000 payable in 30 days and buys at the same time the £1,000 for delivery to him in 30 days at the prevailing 30-days-forward buying rate of 4.85 he knows that the goods will cost him $4,850 and he need not concern himself further about any exchange fluctuations, for here also his exchange risk is covered. A London merchant selling or buying in U. S. dollars would in like cases sell or buy dollars.

The merchant or banker, whether he buys or sells goods, lends or borrows in foreign money, always knows by consulting the exchange-market quotations the sum of domestic currency he will receive or have to pay, provided he "covers" these sales, purchases or loans. He thus not only excludes the risks that lie beyond his own field of action but is able to deal in his records with definite and final amounts.

These examples illustrate the general case where business is done between countries with relatively stable currencies and where it is desired in either country to exclude the risk in dealings with

the other on account of the usual fluctuations in the exchange market. Under unusual conditions, if, for instance, one of the two currencies is relatively unstable, covering of risks involved in business done in unstable moneys takes place only in the stable medium. If both currencies have become unstable a stable medium of exchange is selected.

There would have been, for instance, little advantage for a Belgian merchant to cover in Belgian francs his transactions in French or Italian money, for the three currencies, independently from each other, displayed considerable ups and downs. His only reason for covering in that manner would have been that this foreign business could thus have been finally expressed in his books in definite amounts of Belgian francs. If he had wanted an actual cover and could have lawfully and economically done so he should have selected Dutch florins or U. S. dollars as the more stable basis, for inasmuch as the act of forward selling or buying merely transfers the risk from one currency to another it is wise to place the risk where it is the smaller.

Covering an exchange risk is merely what the term implies. It is not a means to profit by the fluctuations of the exchanges but serves to exclude the risk of incurring a loss through them, at the same time also relinquishing the chance to make a profit. Covering means, therefore, the forward selling or buying of foreign currency according to business needs. Anything more or less than this means incurring a risk.

The question whether exchange risks should be covered or not, and to what extent or in what manner, is one of nice judgment. The answer, aside from the economic conditions of the moment, depends largely upon the cost to insure against the risk. The rate of interest and the margin between spot and forward rates of exchange should first of all be considered. With interest at 45 per cent. per annum (Austria) or even 3 per cent. per day (Poland) and margins between cash and forward rates of 50 per cent. (German marks) it is likely that the exchange risk will not be or remain covered.

During the greater part of the war it was, furthermore, very difficult to deal in some of the foreign currencies, there often being no demand or supply. In several countries prohibitory legal or fiscal measures often made it impossible freely to dispose of domestic as well as foreign funds. Considering all this and much more that could be mentioned on this broad topic it will be seen

that a complete elimination of all exchange risks is not always possible or advantageous in actual practice.

THE CONSUMER

The individual wage earner and consumer, through the effect it has upon his daily life, soon becomes aware of any marked instability of currency values, though he may not understand what causes the trouble. In a period of inflation his nominal wages gradually increase but their relative purchasing power becomes impaired and for more wages he has to be satisfied with less goods. Germany furnished the striking example of the difficulties that beset an entire population in such times.

Many were the attempts to offset the results of the inflation, especially in the latter half of 1923 when the mark dropped in ever increasing tempo. Wage scales were revised frequently, though never so often that the new rates of pay could offset the continuous reduction of the purchasing power of the money. Wages were paid more frequently, even daily, so that the workmen could take advantage of the day's prices. Some of the larger concerns issued their own token money, often representing gold marks, exchangeable within a definite time limit for paper marks at current value. Cases are known where wages were credited to the workmen in work-hours against which they could draw paper marks at then prevailing wage scales. In other cases part of the wages were paid in foodstuffs and probably other methods were current in an earnest endeavor to counter the effect of dwindling money values. None of these attempts, however, could do more than partly bridge the gap between the values of yesterday and today, and on the whole actual wages became lower and lower.

The people reacted to these conditions in many ways. Money was spent as soon as possible: everyone bought food and other necessities immediately for fear that tomorrow it might purchase smaller quantities. There was no incentive to save, for money not spent might have appreciably decreased in buying value the next day. Everyone, therefore, took pains to acquire things with better inherent value than money and whatever remained was rather invested in tangible objects (Sachwerte) for future use or sale than allowed to melt away overnight.

The position of government employees and other large classes of people who had thus far lived on a fixed salary, pension or mod-

erate income from investments—especially government or other bonds or similar "gilt edged" securities—was even worse. They often saw their actual income reduced to almost nothing—in most cases without even the occasional relief afforded to workers in the industries and trades.

But with all his troubles the average citizen as such did not have to solve questions of finance beyond getting his money's immediate worth, nor was he worried with problems of book record.

THE SHOPKEEPER AND SMALL MERCHANT

As individuals the shopkeeper and small merchant shared the troubles of the average wage earner and consumer but they had also to combat those resulting from the nature of their business. If they gave credit they found that the sums finally collected had a decreased purchasing power and they soon came to the conclusion that it was necessary to sell for cash. At the same time their purchasing on credit had to cease or was much restricted. But the principal difficulty was the necessity for maintaining a stock of goods without knowing at what price to sell. Their sales were made at what seemed a good profit, amply providing for taxes and expenses, but nevertheless they found that out of the moneys taken in they could not keep up their usual supply of merchandise. The well known saying—more picturesque than accurate—of Prion's merchant: "The more I earn the poorer, and the bigger my collections the less solvent I become," was certainly inspired by these anomalies.

The following example, wherein fluctuations of actual market or gold prices or the incidence of taxes and expenses are left entirely out of consideration, shows the effect of rapid currency inflation upon the preservation of capital and illustrates how "when the value of money is greatly fluctuating, the distinction between capital and income becomes confused." For simplicity's sake it is further supposed that the original stock represents the entire capital employed in the business and that proceeds from sales are used as much as necessary or possible to replenish it.

The statement on the next page shows:

(1) Of the apparent profit of M 200 on the first turnover M 100 is needed together with the original capital of M 1,000 to repurchase the original stocks. Instead of 20% the profit is only 10%.

(2) After the second turnover at an apparent profit of M 300 the proceeds of M 1,400 together with the M 100 real profit from the first transaction or M 1,500 will purchase only three fourths of the equivalent

	Quantity bought	Cost	Sold for	Apparent profit	Capital available: Apparent	Capital available: Actual	Capital gain* or loss
		Paper marks				Gold mks	
Original capital	...	......	......	.....	1,000	1,000	......
1st turnover	100	1,000	1,200	200	1,200	1,100	*10%
2nd "	100	1,100	1,400	300	1,500	750	25%
3rd "	75	1,500	2,200	700	2,200	500	50%
4th "	50	2,200	10,000	7,800	10,000	250	75%
	325	5,800	14,800	9,000			
5th "	25	10,000					

of M 750 (gold). Instead of over 27% profit there is a loss of 32% on the working capital of 1,100 gold marks.

(3) The turnover (of the reduced stock) produces 700 mks. apparent profit but with the proceeds of M 2,200 only one half of the original stock can now be purchased. As actual capital there remains therefore M 500 (gold) for which there can be purchased only one half of the original amount of merchandise. Instead of making a profit of almost 50% there is a loss of one third of the 750 gold marks that were left.

(4) The merchant now sells this one half at such a high price that the profit will seemingly much more than make good all his former losses, but what is the result? For ten times the original capital he can buy only one fourth of the original goods. Instead of turning over his merchandise at about 350% profit he actually loses 50% of the capital that was left.

(5) The balance-sheet after the fifth purchase will be as follows:

Assets	
Stock in trade	Mk. 10,000
Liabilities	
Capital	Mk. 1,000
Surplus	9,000
	Mk. 10,000

(6) The profit-and-loss statement will be:

Sales	Mk. 14,800
Less: Cost of goods sold	5,800
Profit	Mk. 9,000

The books, such as were usually kept, showed that a profitable business was done but in reality the results were very different. Many shopkeepers and traders were not aware of what actually happened to them until part of their capital was lost and even if they had been they could not have stopped their downward course. The same necessity which compelled them to sell only for cash made it impossible for them to buy on credit. Nor could they borrow capital from local banks or other sources except perhaps at short-time rates wherein the possibilities of losses through depreciation were discounted. They learned very soon that it was to their advantage to make debts and defer their payment as

much as possible, but everyone else also found it out and this avenue of escape was soon closed.

The only way to safeguard their capital was by quick turnover at prices sufficiently higher than cost to permit a complete replenishment of stocks and to provide for taxes and expenses. Even if this obvious truth was occasionally recognized it was, also on account of government price control, seldom possible to act upon it. Furthermore, in most trades retail prices thus far established at certain percentages not varying greatly above the nominal cost, reacted much more slowly to the steady deterioration of the currency than did wholesale values, the latter more readily adjusting themselves to the world market. Toward the end of the inflation period sales prices were increased at short intervals but in the vast majority of cases these increases could not keep pace with the constant fall of currency values. Actual losses became almost inevitable and whatever profits the accounts showed, the resources dwindled. Even if the capital could be restored from time to time by a loan, the profit arising through repayment in money of lower intrinsic worth was soon offset by the almost inevitable actual losses on the sales of the merchandise that was bought with the borrowed funds. Real tangible values (Sachwerte) thus were and had to be constantly exchanged for tokens (Papierwerte), the real or gold value of which decreased more rapidly than the nominal sales prices increased.

Inasmuch as even the symbols used to record business transactions had lost their former definite meaning, ordinary accounting lost its significance. The usual methods no longer sufficed to give a correct view of the business and an understanding of what actually happened. No wonder, therefore, that the small business man came to bewilderment and grief when he continued too long to have faith in his books.

THE SMALL MANUFACTURER WITHOUT FOREIGN AFFILIATION

The greater complexity of the manufacturing business made its financial and accounting problems more intricate. The small manufacturer who bought his raw materials and sold his product in his own country not only shared the difficulties of the general consumer and trader but had more added to them. Generally speaking, these extra troubles arose almost exclusively out of the ownership and renewal of his plant and equipment. At the same time he was confronted with the difficulty of maintaining his

supply of raw materials just as the shopkeeper had to maintain his stock in trade. In order to make real profits and not see his capital impaired he had to sell his product at a sum of currency which more than provided for the reproduction of goods of the same real value. Through government control of prices he was not always able to do so even if he had become aware of the necessity.

Very soon he also saw that with falling currencies there was special danger in underestimating the provision required for depreciation and renewal of plant. The plant accounts, as illustrated before in THE JOURNAL OF ACCOUNTANCY (March, 1927; *Effects of Inflation on German Accounting*, by Henry W. Sweeney) soon became a conglomerate group of figures expressing dissimilar units of value of which the aggregates were altogether meaningless. Depreciation calculated thereon by the customary methods would have been equally meaningless and illusory and would have resulted in the provision of an inadequate amount.

The obvious method to give meaning to the plant accounts and depreciation reserve consisted of converting them to a gold basis. Every addition to the original gold balance of the account thus had to be converted from paper into gold at the actual rate of exchange prevailing at the time of payment. Furthermore all depreciation had to be based upon these gold values, i.e., the currency equivalent of the gold depreciation had to be considered as part of the production cost. But this was not always possible to do. In various countries it was forbidden to keep the accounts, including the property accounts, on any other than the currency basis because currency and not gold values remained the basis of assessment for taxation.

A balance-sheet drawn from the books could therefore serve no purpose and had to be given meaning by valuing in gold or in the currency equivalent of the day all items of stable value like fixed assets or raw materials. They had been recorded in currency at different dates when different exchange rates prevailed and their value would for that reason now be expressed by amounts entirely different from what the books showed. The book entries of those times have been strikingly compared with "fractions of which the numerators are shown but not the denominators."

A profit-and-loss account could not be made up at all. As said by an excellent authority, "The figures as they appear on the account—and in a business of any size there are thousands of

them—appertain to various periods of a year of fluctuating currency; each one of them is expressed in a unit of value which is different from the units of value in which the other items are expressed, and logically they can not be aggregated. Under such circumstances the profit-and-loss account becomes a travesty. The only means of arriving at the result of the trading for a certain period under such circumstances is to compare the balance of the . . . assets and liabilities . . . at the end of the period with that at the beginning. . . . For practical reasons and apart from the disqualification of the mark as money it would appear simpler to express the statements (balance-sheets) straight away in a stable currency."

The average small manufacturer or merchant was in many respects at a disadvantage compared with manufacturing and trading concerns with foreign affiliations. It took him considerable time to realize the dangers of the exchange situation, whereas the concern with foreign associates, through its closer contact with the world market, became aware of these dangers at a much earlier stage. Even when he recognized the danger the small business man had not the means whereby he could avoid it. If through government interference or other causes he could not charge for his goods the prices that would bring him an equivalent for the gold value of his depreciation, materials, labor and expenses, he was bound to lose.

In the earlier stages of the inflation he might have saved his capital from impairment through constant purchase and repurchase for future delivery of the gold value of his capital not invested in stable gold assets. Later, however, he could not lawfully have done so because of the restrictions imposed upon the export of domestic capital. Moreover the increasing cost would in the end have made constant repurchasing almost impossible.

THE CONCERN WITH FOREIGN AFFILIATIONS

The concern which in a period of inflation of the domestic currency sold to foreign countries with stable money and bought in the domestic market had the advantage of collecting gold and paying out paper currency and therefore needed no cover. In a declining market such a concern would not make any actual exchange profits for although it would receive more marks for its gold these marks would be themselves of smaller intrinsic worth. After deflation had set in the original gold value would still be

collected and consequently there would be no exchange loss. The nominal mark equivalent would be smaller but the marks collected would be of greater real value.

Under conditions of deflation there would likewise be no incentive to cover against losses on marks. If it had been thought that the mark would go up the sales could have been made in marks. If in these circumstances the sales had to be made in florins just the same, for the purchaser would in all probability not have bought for marks, a forward sale of these florins as long as they were of stable gold value would not have been a covering of risk but an exchange speculation. As already mentioned, covering is not resorted to for the sake of an exchange profit but to guard against an exchange loss and is always in a stable currency, or at least the more stable of two currencies. If the value of the mark had gone up in relation to the florin only, or, in other words, if the value of the florin itself had gone down, a forward sale of the florins for a more stable currency—say U. S. dollars—would have constituted a legitimate cover.

The concern which in such a period bought in countries with stable money and sold in the domestic market collected paper currency and had to pay in gold. With money depreciating there would be an exchange loss unless at the time the goods were purchased there was also bought for future delivery the amount of stable money payable. This is, of course, the same as selling forward the corresponding amount of paper currency.

In both instances the risk of a loss can be excluded either by selling in gold or by forward selling or buying of proceeds or requirements. In several instances this could be done to a certain degree either in the foreign or in the domestic exchange market. When the fluctuations became more severe several governments took steps to prohibit by law the flight of capital and forward selling of the paper currency in the countries concerned became subject to strict government regulation.

Here it was that an agent or an office in a country with relatively stable money conditions became of great advantage. In these countries the exchange markets were free to everyone and what was prohibited or regulated at home could be readily done abroad. For this and many another reason some of the large concerns in central Europe opened offices in Holland or organized Dutch companies so that they might be able to cover their exchange risks to the full extent which the market permitted. These

branch offices may also have facilitated the flight of capital and other attempts to escape losses or evade taxes, but in most cases they covered exchange risks and served other entirely legitimate purposes, as, for instance, insurance and raw material purchases.

Insurance especially offered great difficulties. Probably in all countries insurance companies are required by law to invest their reserves in first-class domestic bonds which are often without a gold clause and thus payable in currency. This made it impossible to fulfil obligations on a gold basis. Proper safeguarding was, of course, easier in a country without serious currency problems.

THE FOREIGN HOLDING COMPANY

A concern situated in a country with comparatively stable money, with large investments in the industries of countries with unstable currencies, thus directly or indirectly owning factories and managing their operations, feels the effects of exchange fluctuations much earlier than do the foreign companies themselves. Such a concern is in closer touch with international finance and with raw-material and sales markets, and is in various ways directly tied to the gold standard of value. Immediately when it perceives the effect of even slight exchange differences upon its dealings with other countries it is apt to cover against such differences even in normal times. In the purely domestic affairs of the other countries these normal fluctuations are not noticed and only after they have caused considerable changes in the general price level are they felt and recognized.

The problems of financial and accounting control multiply as soon as a period of instability and inflation sets in and it becomes more and more difficult to preserve the foreign assets, determine the actual profits and transfer them to headquarters. The transfer of profits often had to be effected in spite of legal obstructions and arbitrary fiscal measures in the foreign countries.

It will be of interest to see how the head office in these circumstances had to treat the customary groups of assets and liabilities as they stood on the subsidiaries' books so as to produce reliable gold balance-sheets for head-office purposes of scrutiny and consolidation.

It will probably suffice to set forth in general terms by what means this may be done and to omit tedious examples and description. For those who are not familiar with foreign exchange

or have not studied or experienced the consequences of prolonged monetary instability the problem may perhaps be presented more explicitly and in the end more satisfactorily by working out a short example and discussing the main features of the procedure in a somewhat elementary way. It may also be of general interest to show in the course of the argument the practical, although today rather obvious, accounting devices that were applied after proper understanding of principles commenced to develop out of great confusion of thought.

For the purpose of this discussion suppose that the financial head office of such a holding company is situated in Holland. A totally owned subsidiary company is in Germany and the gold mark is worth .60 florins. The ownership dates from before the war so that no exchange questions need be considered with reference to the subsidiary company's capital at acquisition or the discount or premium at which it was acquired. It is, of course, quite possible that the florin was not the most stable basis available, but this question need not enter the discussion.

FINANCIAL RELATIONS BETWEEN HEAD OFFICE AND FOREIGN SUBSIDIARY

At this point one should look for a moment at the financial relations between head office and subsidiary company.

The head-office investment consists of the amount paid for the subsidiary company's stock, bought either at par, at a premium or at a discount, and of certain advances for additional capital, including profits and losses transferred to headquarters. The total, after taking premium or discount into consideration, represents the subsidiary company's actual net worth in gold. This net worth is represented on the subsidiary's books by:

(1) Assets of stable gold value like land, buildings, machinery and equipment, raw materials and other stocks, balances collectable in gold, etc., less gold liabilities.

(2) Assets of nominal paper value like domestic amounts receivable and bank and cash balances, less paper debts.

Under abnormal exchange conditions the preservation of the net worth, that is, of the head-office investment and advances, calls for special attention. Before steps can be taken for this purpose the extent of the loss or gain already incurred and of the yet existing risk must be determined. It will, therefore, be neces-

sary to know, as at the date when it is intended to take these steps, (a) to what amount the head office advances, which all represent an outlay in gold, are still represented by *actual* values and (b) to what extent these values are stable or unstable. In other words, first the capital or exchange loss or gain already existing and second the exchange risk of the immediate future must be ascertained.

PRELIMINARY STEPS TO ASCERTAIN CAPITAL LOSS OR GAIN AND EXTENT OF EXCHANGE RISK

It may be supposed that the balance-sheet of the subsidiary company on the date of acquisition by the holding company, when the mark was worth par (or f. 60) was as follows:

A. Balance-sheet of subsidiary company at acquisition

	Mks.	Fls.
Assets		
Fixed assets	1,500	900
Net current assets	3,000	1,800
	4,500	2,700
Liabilities		
Capital:		
Capital stock	2,000	1,200
Surplus	2,500	1,500
	4,500	2,700

Head office acquired the capital stock at the book value of the net assets, viz. Mk. 4,500 @ .60=f. 2,700, and charged investment a/c.

It may be further supposed that the subsidiary company

(1) Spends Mk. 1,300 of its current funds for capital additions. The mark had dropped at the time to .25.
(2) Spends Mk. 500 for domestic supplies, after the mark had dropped to one tenth of its gold value or .06.
(3) Writes off 10% depreciation or Mk. 150.

It also may for the present be assumed that head office deals with the subsidiary company in marks and

(1) Advances Mk. 3,700 @ .06 for capital additions.
(2) Sells subsidiary raw materials costing f. 600 for the equivalent of Mk. 10,000.

In the last paragraphs of the next section of this article the effect of dealing in gold with the subsidiary company will be discussed.

Since these actions the exchange rate has dropped to .03 and it is desired to determine to what extent the head-office investment and advances are still represented by actual values and what is the exchange risk inherent in the existing position.

Accordingly a balance-sheet is prepared wherein actual present gold values are shown. Such a balance-sheet can as a rule not be drawn off the books for they will at this time be practically worthless as a record of values; nor can they be restored to ordinary usefulness under such conditions unless it is feasible to keep them in a stable currency. Even this, if permitted under the laws, would cause great difficulty, for the numerous transactions in the fluctuating medium would all have to be translated into the stable one. For this reason the local books were, barring exceptional cases, kept in the domestic currency even if it was quite well known that aggregates had little or no meaning and that almost every transaction had to be considered by itself in so far as its actual bearing upon the financial position was concerned.

The aforementioned balance-sheet can therefore be prepared only by taking account (1) of the exchange rates prevailing at the moment when assets usually valued at cost—as, for instance, fixed assets—were acquired or when any existing gold liabilities were incurred, and (2) of the changing market values of other tangible assets of more stable worth than legal tender, as, for instance, raw materials and other stocks.

The fixed assets would accordingly be valued as follows:

	Marks	Rate	Florins
Value at acquisition	1,500	60	900
Additions	1,300	25	325
Additions	3,700	6	222
	6,500		1,447
Depreciation	150	60	90
Present gold value	6,350		1,357

The foreign-bought stocks would still be worth their original cost of f. 600 and their currency value at the above exchange rate is therefore Mk. 20,000, showing a book profit of Mk. 10,000. The domestic stocks, on account of the drop in the exchange rate, now have a market value of Mk. 800, and show a book profit of Mk. 300. Receivables and cash and any currency debts will be taken up at their book value in currency at the prevailing rate of exchange. The books thus show an operating loss of Mk. 200, which includes Mk. 150 depreciation or 10 per cent. of the book

value of the fixed assets at the beginning of the period. The balance of the loss, Mk. 50, shows in the decrease of the book value of the net current assets which is now Mk. 1,150. The difference between assets and liabilities thus valued will be the gold capital of the subsidiary company.

Under the foregoing assumptions the balance-sheet will be as follows:

B. Balance-sheet at date of cover

	Mks.	Fls.
Assets		
Fixed assets	6,500	1,447
Less: Depreciation	150	90
	6,350	1,357
Stocks—foreign	20,000	600
" —domestic	800	24
Other current assets—net	1,150	34.50
	28,300	2,015.50
Liabilities		
Capital	4,500	1,301.50
Surplus	10,100	303
Head-office advances	13,700	411
	28,300	2,015.50

The profit of Mk. 10,100 is made up as follows:

Increase in the book value of	
Foreign stocks	Mks. 10,000
Domestic "	300
	Mks. 10,300
Less: Operating loss	200
	Mks. 10,100

It will be transferred to head office which will then show a total of investment and advances as follows:

	Mks.	à	Fls.
Investment account	4,500	.60	2,700
Advances:			
For capital expenditure	3,700	.06	222
For raw materials	10,000	.06	600
Transfer of profit	10,100	.03	303
	23,800		1,125
Together	28,300		3,825

The foregoing balance-sheets A and B will now permit a comparison of conditions at their respective dates.

(*To be continued*)