CHAPTER ONE

Research Methodology

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CHAPTER ONE
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1) INTRODUCTION:

International trade, multinational companies, foreign investments, and establishment of branches and subsidiaries in foreign countries are not new subjects. However, after the cold war the world has come to a new economic and political stature, which is being built on globalization and economics of the free market.

Many countries normally do not enact laws and frame regulations to control the movement of capital. On the other hand, many countries encourage foreign investment and open the doors for collaboration with other countries. In this regard, there are many international organizations such as the World Bank, WTO and International Monetary Fund, which encourage the opening up of economy of members.

As a sequel this has led to increase volume of international trade and encourage corporate unites to establish more and more foreign branches or subsidiaries in foreign countries. All that has taken place under complex economic conditions, due to cutthroat competition, rapid development in communication technology, inflation and fluctuation of foreign exchange rates.

Fluctuation of foreign exchange has become a challenge to accounting practices as well as to accounting thoughts. It has posed a dilemma and not an ordinary problem because practice of fixed national currency system against foreign currencies has stopped and free exchange system has taken its place, as a result the currency becomes like any another commodity which has a market and has prices according to demand and supply mechanism. This free exchange system has led to fluctuation in foreign exchange rates. As a result, there are different operative rates for national currency during the financial period.
The change in foreign exchange has not become an economic problem in certain countries only but it has also become an international economic phenomenon.

This environment has pushed and pressurized many countries to issue national accounting standard to deal with these economic phenomenon and generated accounting problems. For example: In USA SFAS, 52 was announced to supersede SFAS no 8 with respect to accounting for effects of change in Foreign Exchange Rates, in UK SSAP, 20 and in Australia AAS 20.

India was not an exception. In 1976, the Institute of Chartered Accountants of India ICAI issued a statement on “Accounting for foreign currency translation” to bring uniformity. In 1988, some rethinking was done by ICAI on the same statement. The ICAI was compelled to reconsider the statement, consequently an exposure draft (ED) was issued on “Accounting for effects of change in foreign exchange rates” Thereafter a standard, AS11 in respect of “Accounting for Effects of change in Foreign Rates” was issued in 1989 by ICAI. However, the policy of liberalized exchange rate mechanism and the full convertibility of the rupee on current account announced by the Indian Government in March 1993 compelled the ICAI to review the standard and exposure draft(ED) to revise AS11 was issued in August 1993. Moreover, revision by ICAI was done in 1994 for standard AS11, and last revision in 2003 to harmonize the AS11 with international accounting standard No. 21. (See, ICAI, 1976, 1994, 2003; Saraf, 2001; Jita, 2001).

International Accounting standards Committee (IASC) has issued international accounting standard IAS 21 in 1983 for “accounting for effects of change in foreign exchange rate “After 1983, several revisions have been made (i, e., in 1993 and in 2003).

The fluctuation and change in foreign exchange rates is not only an international economic problem but also its international accounting problem, as this change in foreign exchange creates a number of different rates for national currency during the financial period.

Under such circumstance companies and firms concerned face two major
accounting problems (Flower, 2002:582):

1. Problem in respect of which exchange rate should be used to translate foreign currency balances to domestic currency?

2. Second problem is how should gains or losses on translation (exchange difference) be reported in the accounts & financial statements?

Both the said problems should be solved through accounting treatment, which enables the firms and companies to fulfill their objectives and enables them to overcome the risk of fluctuation in foreign exchange. Thus, accounting treatment should give attention and full consideration in respect of credibility of financial statement as well as its usefulness in decision making nationally and internationally. Moreover, comprehensive accounting treatment should observe Generally Accepted Accounting Principles (GAAP) and accounting managerial and economic aspects of foreign exchange, besides these the effects of inflation on translating financial statements should be considered in order to provide information which is useful to predict and to evaluate future cash flows and properly to judge the operating performance of the corporate.

In fact the accounting for effects of change in foreign exchange, related to more than one element, which should be considered. This situation will be more complex when we deal with overseas investment and foreign branches & subsidiaries of the companies. Therefore, there is no exaggeration if we confirm what was said in accounting thought by some scholars in international accounting field, that translation of foreign currency and accounting and reporting for effects of change in foreign exchange is a crucial and sensitive issue and challenge before international business as well as before accountants in different areas in the world (Choi and Mueller, 1984:109).

Hence, this situation may increase the burden of responsibility of those who are concerned with international accounting affairs in searching for accounting techniques and models, which should give full consideration to all elements related with the phenomenon of fluctuation of foreign exchange, as well as importance of quality of financial statements on national and international levels through accounting justice which is not only theoretical concept but also general framework guiding
accounting practices and profession in producing information which serve all parties and users of financial statements for evaluation and decision making.

The stability of international accounting environment is a vital element, which serves international economy and movement of capital particularly in developing countries, which are actually suffering from both lack of investment and high fluctuation of foreign exchange. In this respect, we need awareness and rational harmonization between national accounting practices for development of accounting profession as well as opening more investment opportunities before developing counties economies.

We can say that the international accounting problems may gradually formulate and pave the way towards development of accounting language and transferring it to international language, as well as these problems may increase the need for harmonization between national accounting practices.

Although the problem of fluctuation of foreign exchange has gained accounting attention nationally as well as internationally. There are many studies and researches, which have tried and are still trying to find conceptual framework to guide accounting practices, the need still remains for more accounting efforts to encounter this serious problem, in foreign exchange and analyzing and understanding it comprehensively in international level as well as in national.

If we are speaking particularly about accounting efforts made in developing countries, we can say clearly, that there is lack of accounting efforts in respect of fluctuation problems in foreign exchange. Really phenomenon of fluctuation in foreign exchange has not met due attention in developing countries. In addition, there are limited scientific accounting researches in studying, criticizing, analyzing accounting practices, which were adopted by different companies to face the risk of fluctuation of foreign exchange.

2) SCOPE OF THE STUDY (problems envisaged in the study):

We can summarize the problems of the study through the following questions:
1. What are the accounting practices related to the effects of changes in foreign exchange rates in Yemen and India with references to selected companies in two countries? And are these accounting practices in agreement with the requirements of international accounting standard (IAS NO 21) or not?

2. Is there awareness and perception of significance of exchange rate changes and its impact on the corporate units concerned?

3. Do companies take into consideration the effects of domestic and foreign inflation, when translation of financial statements of their foreign branch and subsidiary is made?

4. Do companies take into consideration the exchange rate fluctuation while setting their capital budget or making capital expenditure decisions?

5. Which accounting approach and treatment of foreign exchange problem should be adopted according to economic situation in the two countries and considering needs of the users of financial statements to relevant information for decision-making (decision-oriented framework)?

3) OBJECTIVES OF THE STUDY:

This study has been conducted keeping in mind the following objectives:

1) To study the accounting approaches and methods in measuring and reporting for effects of changes in foreign exchange rates and evaluate them in light of the objective of providing relevant accounting information for decision making.

2) To undertake critical, comparative analysis between accounting practices in (India and Yemen) in respect of accounting and reporting for effects of changes in foreign exchange rates comparing with international accounting standard IAS 21.

3) To study and to compare accounting standards in selected countries regarding foreign exchange problem

4) To suggest the proper accounting approach, that is suitable to companies, in Yemen and India.

5) To make some recommendations that may improve the accounting practices and profession in Yemen and India
4) HYPOTHESES OF THE STUDY:

Keeping in view the above-mentioned objectives, the following hypotheses are set by the researcher for the purpose of this research work:

A). The hypothesis related to the theoretical study:

1. “The accounting approaches and models of currency translation of financial statements ignore the inflation problem”.

B). The hypotheses related to empirical study:

1. “The accounting practices of companies in Yemen and India in respect of accounting and reporting for effects of changes in exchange rates are, fully in disagreement with the requirements of IAS NO 21(1993)”

2. “The International Accounting Standards 21 is not suitable and applicable to Yemen and India “

3. “There is an awareness and perception of significance of exchange rate fluctuation and its impact on different aspects of the company.”(i.e., its performance, decision etc).

4. “The companies do not take into consideration the effects of domestic and foreign inflation when translation of financial statements of their foreign branches, subsidiaries and associates”.

5. “The finance factor occupies advanced class amongst other economic indicators in the classification of foreign operations into independent foreign entity and integral foreign operation.”

6. “The statement of foreign currency transaction is not useful for decision making”.

7. “There is no need for issuing separate accounting standard for Banking Sector regarding accounting for the effects of changes in foreign exchange rates”.

8. “The companies take into account the exchange rate fluctuation when setting their capital budgets or making capital expenditure decision.

5) SIGNIFICANCE OF THE STUDY:

The accounting for effects of change in foreign exchange, which is considered as the main and crucial issue in International Accounting, because fluctuation of foreign
exchange has become an international economic phenomenon, most countries in the world suffer from it, particularly the developing countries, like India and Yemen.

Linking accounting practices in developing countries with international accounting standards (IAS) its attempts may lead to guiding and improving quality of accounting outputs in the said countries and this link may support opportunities of establishing suitable international accounting environment towards encouragement of investments and movements of capital in the world economy, generally and in the developing countries economics particularly. **This link is one of the objectives of this study.**

Actually, there are increasing trends towards globalization, free economy and expending companies across the world; in this case, the foreign investors will give more appreciation to companies, which are adopting international accounting standards IAS, due to different reasons. (i.e., these reasons require separate accounting studies and it is out scope of this dissertation).

This study is in the **field of comparative international accounting**, which requires more in- depth studies and researches.

Finally, what makes the present study more significant attributes to comparative international accounting through two accounting models within the developing countries (India and Yemen). Without doubt this field is suffering from clear lack of scientific accounting studies.

**The developing countries are a group having similar economic characteristics.** This situation made the study of comparative accounting in the above-mentioned countries more fruitful and beneficial. In the developing countries, more than any other countries of the world, the national currencies suffer more from fluctuation in comparison to those in other foreign currencies. Developing countries also suffer from high inflation rates besides the above-mentioned problems. These countries also suffer from lack of Capital Investment.
These conditions magnify the responsibility of the individuals, who have interest in accounting affairs in the developing countries, with a desire to improve the accounting practice and getting benefits from different experiences. In addition to that India and Yemen both countries had implemented fixed system of national currency against foreign currencies, but now they have adopted liberalized system in exchange market, so the fluctuation and change in foreign exchange rates has become an economic phenomenon and problem to both these countries.

The situation should be studied and analyzed towards finding accounting treatment, which will agree with economic situation and is based on the objective of financial statement, which provides useful information for decision-making and is also guided by international accounting standards (IASs) to serve investment issues and economic development in both the countries.

6) TECHNIQUES OF THE STUDY:

In conformity with the nature and objectives of the study, the researcher has adopted two techniques:

- Technique of the theoretical study
- Techniques of the empirical study

The theoretical study:

The data was collected from different secondary sources such as:
Books, professional journals, previous studies and published researches. And special attention paid to the publications of http://www. Of Accounting Institutes and Bodies such as //www.ICAI, FASB, AAA, AICPA, IASB, www.IFAC.org, GCCAAO, ASCA, SOCPA, www.OECD

The theoretical study of the thesis has been conducted to fulfill the following objectives:
To understand the conceptual framework of the exchange rate.
To review the accounting literature related to the topic of the thesis
To study accounting approaches in measuring and reporting for the effects of exchange rate changes and to critically evaluate them in the light of decision-oriented framework.

To study and to compare accounting standards and practices in selected countries to understand the international scenario.

Thus, the researcher has employed A Comparative Analytical Approach. The Positive Theory also is used to understand managerial preferences of selecting accounting policies and to explain and to predict “accounting phenomena”(please, see, Almotyry et al., 2002).

The empirical study:
The empirical study of this thesis has been conducted to study the accounting practices actually adopted by selected companies in Yemen and India regarding effects of exchange rate changes and to compare these practices with the requirement of IAS NO 21 (1993).

The empirical study has relied on:
➢ Analysis of Annual Reports of Selected Companies
➢ Questionnaires

Besides these, interviews were conducted and observations noted to integrate with other sources to get full understanding for the topic of this study.

(A) Analysis of the Annual Reports:
Sample size and sampling methods:

India:
To understand properly accounting practices of foreign currency translation in India, the researcher has relied on the sample, which can reflect the accounting practices comprehensively, and objectively, therefore the researcher has depended on the list of top 500 Indian companies issued by the economics times in June 2003.

As the topic of this thesis related to international accounting and foreign exchange relates to foreign trade and international companies thus, the researcher has applied the following criteria in selecting sample companies (from this list of top 500 Indian companies):
1) Company should have foreign currency transactions
2) Company should have foreign entity (i.e., branch, subsidiary and associated, joint venture).
3) Company should have consolidated financial statement of the parent and its foreign entity in its published Annual Reports
4) The Annual Reports should be available for five financial years (2000-2004).

The researcher found (100) companies from that list which fulfilled the above criteria. From (100) International Companies 30% (i.e., 30 International companies) have been chosen on the basis of simple random sampling.

The size of the sample was suitable to study comprehensively (i.e., in-depth study) accounting practices of foreign currency through thirty Giant International Indian companies.

The sample has covered the most important sectors in Indian economy (i.e., IT sector, manufacturing, and banking).

The sample companies listed on the Stock Exchange Market and they are joint stock companies. All of them have included the Certificate of Corporate Governance (CCG) and some of them have been rewarded by ICAI for their excellent Annual Reports for example, Infosys, Reliance, and Tata Group. This has made the study sample more reliable to draw and to infer conclusions, with pragmatism.

The list of Indian companies included in the study is in appendices section of this thesis

Yemen:

To understand the accounting practices in Yemen regarding foreign currency, the researcher has relied on the joint stock companies because they have published Annual Reports.

The researcher has relied on the record of Ministry of Industry and trade (www.yemen.gov.ye)

The researcher has applied the following criteria to select the sample:
1) Company should have foreign currency transactions
2) The Annual Reports should be available for five years (2000-2004)
After application of above criteria, the researcher found (80) companies and only 17 companies co-operated with researcher and handled over their annual reports or allowed to the researcher to access to them. Thus, the seventeen companies were included in this study.

The sample covered the most important sector in Yemen economy (i.e., banking, manufacturing, insurance, real estate). **The list of sample companies is included in the appendix section of this thesis.**

The Annual Reports and data were collected from the following sources:

- Journals (capital market)
- Bombay stock exchange, Bombay
- Poona stock exchange
- Center for monitoring of Indian Economy (CMIE), Bombay
- National Institute of Bank Management (NIBM), Pune
- Gokhale Institute of Politics and Economics
- Chartered Accountants
- Companies themselves

(B) Questionnaires:

In the light of previous studies related and objectives and hypothesis of the this study and the requirements of IAS NO 21, the researcher has prepared questionnaire to understand views and attitudes of the related parties regarding foreign currency accounting and reporting and other issues related.

To improve the quality of data collected (i.e., Test of sound measurement) the researcher has presented the questionnaire first to the Experts in Accounting, Statistics and Behavioral sciences in Pune University, NIBM, Delhi University, Symbiosis University and C A firms and TATA Management Research Institute (Pune) and BMCC, Indsearch Institute (Pune), Zaware’s academy of C A (Pune), financial managers, Hodaidah University (Yemen). **The list of Experts is included in the appendix section of this thesis.**

The researcher has modified the questionnaire in the light of the suggestions of experts and selected randomly **the pilot sample** to test the quality of the questionnaire when
the researcher felt satisfied about the clarity of the questionnaire he distributed the questionnaires on the basis of random sampling to **three categories** (in Yemen and in India):

- The practicing chartered accountants
- Financial managers / accountants officers
- Auditors of Supreme Audit Institution. **The table no(1-A)and(1-B) show the sample and questionnaires distributed and responded**

C. **Processing analyzing and presenting data:** The researcher has employed statistical package for social science (SPSS) and Excel for Windows (XP.) in processing, analyzing and presenting data collected from the primary source (Annual reports, Questionnaires). **The descriptive statistics** such as % percentages, Rank are used.

**The Chi- Square Test** has been also employed in this study to find significant differences among the respondents’ answers.

7) **LIMITATIONS OF THE STUDY:**

The following limitations have been experienced:

1. This study has dealt with the subject of accounting for the effects of changes in foreign exchange rates in selected companies (Yemen and India) compared with the International Accounting Standards IAS NO 21 (1993)
2. **The Annual Reports** of companies for **five years** (2000-2004), the list of selected companies studied is included in the appendix section of this thesis.
3. The sample contains data of 17 companies (in Yemen) and 30 companies (in India)
4. The results of this study are based on data analyzed that are based on the sample analyzed.
5. **The questionnaires** were conducted during: From-1-2-2006/30-4-2006(Yemen)
   1-6-2006/30-9-2006(India)
### YEMEN

**Table (1-A): Sample size achieved for various respondents**

<table>
<thead>
<tr>
<th>Category of respondents</th>
<th>Targeted sample size</th>
<th>Achieved completed sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chartered Accountants(CA)</td>
<td>60</td>
<td>50</td>
</tr>
<tr>
<td>Financial Managers</td>
<td>60</td>
<td>50</td>
</tr>
<tr>
<td>Auditors in Supreme Audit Institution</td>
<td>30</td>
<td>20</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>150</strong></td>
<td><strong>120</strong></td>
</tr>
</tbody>
</table>

**RESPONSE RATIO**

\[
\frac{120}{150} = 80\%
\]

### INDIA

**Table (1-B): Sample size achieved for various respondents**

<table>
<thead>
<tr>
<th>Category of respondents</th>
<th>Targeted size</th>
<th>Achieved size</th>
</tr>
</thead>
<tbody>
<tr>
<td>CA</td>
<td>80</td>
<td>70</td>
</tr>
<tr>
<td>Financial Managers</td>
<td>80</td>
<td>70</td>
</tr>
<tr>
<td>Auditors in Supreme Institution((CAG))</td>
<td>40</td>
<td>30</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>200</strong></td>
<td><strong>170</strong></td>
</tr>
</tbody>
</table>

**RESPONSE RATIO**

\[
\frac{170}{200} = 85\%
\]