FINANCE AT A GLANCE

Major Types of Revenues (3) — Lesson 20

In this lesson, we discuss another type of revenue.

Foreign exchange gains

There are three cases wherein a company can earn revenue from exchange rate movements:

1. Sale of goods on credit followed by weakening of the local currency

For example, an American company sold goods to a Japanese company, worth $1,000. The American company issued the invoice in Japanese yen for Yen 100,000, based on the then prevailing rate of $1 = Yen 100. The Japanese client paid the invoice 30 days later (which was still within the year when the sale was made), and remitted Yen 100,000. At the time of the receiving the payment, the dollar had weakened to $1 = Yen 90, and based on that exchange rate, client's payment converted to $1,111.11, which was $111.11 higher than the original value of the invoice in $ at the time of sale. The extra $111.11 was a gain on foreign exchange, which had to be recorded as revenue by the American company.

2. Purchase of goods on credit followed by strengthening of the local currency

For example, an American company bought goods from a German supplier. The supplier issued an invoice worth Euro 1,000. At the time, the exchange rate was $1 = Euro 0.80. Based on that rate, the amount payable was $1,250 (Euro 1,000 divided by $0.80). One month later, when the American company paid the invoice, the $ had strengthened to $1 = Euro 1. Based on that exchange rate, the American company spent only $1,000 to settle the Euro invoice, which at the time of purchase was worth $1,250. The savings of $250 was a gain on foreign exchange that had to be recorded by the American company.

3. Having foreign subsidiaries with assets and liabilities denominated in foreign currencies

This case will be discussed in a future lesson.

Until then,

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