

Accounting and Reporting Reminders on Foreign Currency Transactions and Derivatives

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Functional Currency

- Currency of primary economic environment in which an entity operates
- Not always the local currency; determined based on facts and circumstances
- Foreign operations that are self-contained and integrated within a particular country vs. those that are principally a direct and integral part of a parent company's operations
- ASC 830 (SFAS 52) provides factors to consider

- Changes in functional currency
 - Rare, but possible
 - Significant, long-term changes in environment

- Highly inflationary economies
 - Cumulative inflation rate of 100% over three years
 - Remeasure functional currency into parent's reporting currency

Intercompany FC Transactions

- Unless considered to be of a “long-term investment nature”, they should be treated the same as FC transactions with third parties
- Transactions of a long-term nature are reported in the same manner as translation adjustments
 - Long-term investment nature = settlement is not planned or anticipated in the foreseeable future
 - Foreseeable future = not defined; requires judgment
 - Change in intentions will lead to change in accounting

Statement of Cash Flows Reminder

- ASC 320 requirements:
 - Use exchange rates in effect at time of cash flows
 - Weighted average may be used for translation
 - Carefully apply in periods of volatility
 - Consider timing of significant investing and financing transactions
 - Effect of FCX on cash reported as a separate part of reconciliation of change in cash for the period
 - Practically speaking:
 - Prepare separate statement for each foreign operation in its functional currency
 - Translate into the reporting currency
 - Incorporate into consolidating statement

ASC 815: Derivatives and Hedging

- Hedge accounting is a privilege - all conditions of ASC 815 must be met
- Formal documentation at inception of relationship which describes:
 - Hedged item/transaction
 - Forecasted transaction = estimated nature, date, and amount
 - Sufficient specificity to identify the hedged transaction
 - Hedging instrument
 - Nature of risk being hedged
 - Method that will be used to assess effectiveness
 - Method that will be used to measure ineffectiveness
- Critical terms match method
 - Assumes no ineffectiveness
 - Do terms really match or are they just close?
 - Changes in terms or creditworthiness of counterparty will upset assessment

ASC 815: Derivatives and Hedging

- Foreign currency exposures eligible for hedging:
 - Cash flow hedge: forecasted transaction, unrecognized firm commitment, forecasted functional-currency equivalent cash flows associated with a recognized asset or liability, or a forecasted intercompany transaction
 - Fair value hedge: unrecognized firm commitment or a recognized asset or liability
 - Hedge of a net investment in a foreign operation

ASC 815: Derivatives and Hedging

- FC hedges
- In addition to other criteria required for hedge treatment, also need to meet these specific criteria:
 - Operating unit that has foreign currency exposure is a party to the hedging instrument
 - Hedged item or forecasted transaction is denominated in a currency other than that operating unit's functional currency

ASC 815: Derivatives and Hedging

- Generally - accounting for hedges of FC exposure consistent with other fair value and cash flow exposures
- Two key differences:
 - Net investment in a foreign operation can be designated as a hedged item (dissimilar assets and liabilities cannot otherwise be so grouped)
- Non-derivative instruments can be a hedging instrument of:
 - FC fair value hedge of an unrecognized firm commitment
 - Net investment in a foreign operation

Derivatives - Presentation

- Balance sheet:
 - Measured at fair value
 - Current/non-current classification depends on:
 - Maturity
 - Counterparty's rights
 - Timing of cash flows
 - Instrument may be separated
 - Netting of instruments only appropriate where same counterparty and right of setoff exist
- Income statement:
 - Placement of changes in fair value usually dependent on whether derivative has been designated/qualifies as a hedge
 - Hedging derivatives
 - Typically presented in the same line item as that of the item being hedged
 - Non-hedging derivatives
 - Presentation varies based on industry practices and underlying reasons for entering into the contract
 - Splitting a derivative into more than one line in the income statement is not considered appropriate
 - Required to disclose where the gain/loss is reported

Proposed Accounting Standards Update (ASU)

- Attempt to simplify accounting for hedging activities
- Easier to qualify for hedge accounting
- “Reasonably effective” would replace “highly effective”
- Qualitative assessments of effectiveness would be permissible
- Ineffective portion would still be recorded in earnings
- On-going assessments of effectiveness would be required only if circumstances suggest relationship is no longer “reasonably effective”

- Comment period ends September 30, 2010
- Effective date: ???