

Foreign currency transactions and issues that may arise



Abstract

In today's world international business transactions happen frequently. Many corporations in the United States (U. S.) such as Automatic Data Processing, Inc. (ADP), John Deere, McDonald's, and Wal-Mart to name a few, conduct business in other countries. The collection of monies from imported and exported sales may not be in U. S. dollars but in pesos, yen, or pounds depending on what has been negotiated within the details of the transaction. Since foreign currency rates of exchange change, the U. S. dollar value from the import and export of the sales do the same. With these variations, companies have implemented hedging in order to compensate for those changes. With those fluctuations, issues will arise. This paper will discuss how the accounting for issues are handled in addition to how transactions from imports and exports are treated.

The goal of a currency is to give a standard of significant worth, a vehicle of trade and a unit of measure. Currency forms in other countries play out the initial two capacities with different degrees of effectiveness, however, basically all monetary forms give a unit of measure. In order to gauge the monetary exchange in their very own monetary standards, businesses around the world depend on exchange rates that have been continuously negotiated in the foreign currency market.

Our text defines the exchange rate as “ the price at which the foreign currency can be acquired (or sold).” (Hoyle, et al, pg. 408) There are many factors that determine what the exchange rate will be between the two currencies, however, those that conduct business internationally have to

deal with rate fluctuations. With the exception of forward contracts, the exchange rates used for accounting foreign transaction are as follows: spot rates, current exchange rates, historical exchange rates, and average rates. Spot rates are exchange rates that are available for immediate delivery. Current rate are the rates at which one unit of cash can be traded for another at the balance sheet date or transaction date. The historical exchange rate is the actual date effective date for a specific transaction or event. The average rate –the weighted average of historical or current exchange rates. The use of historical exchange rates protects financial statements from currency translation losses and/or gains.

There is a distinction between translation gains and losses and transaction gains and losses. A translation that is realized creates a gain or loss. The gain/loss should automatically be displayed in the income. A gain/loss on a settled transaction can arise at any time the exchange rate that was used to book the original transaction differentiates from the rate that was used at the time of settlement. A translation

gain/loss will be unrealized as paper gains/losses or as gains/losses on unsettled

transactions.

In order to report domestic and foreign entity relationships properly, there must be some degree of control in the accounting process. The relationship between the foreign and domestic entities suggest the need to combine and/or consolidate the financial statements between the two due to the differentiation of the reporting currency values. Therefore, some type of <https://assignbuster.com/foreign-currency-transactions-and-issues-that-may-arise/>

system needs to be implemented in order to incorporate the foreign entities financials into the domestic entities financial statements (Foreign Currency, 2019). Due to the complexity of foreign currency translation, financial statements of foreign entities need to be adjusted in order to reflect the differences in accounting principles when the statements were prepared. Appropriately identifying foreign entities within an organization is essential in determining the functional currencies of those foreign entities (Ernst & Young, 2018).

There are two major translation methods that are currently being used. Those methods are current rate method and temporal method. Under the current rate method, “ a company’s net investment in a foreign operation is exposed to foreign exchange risk. In other words, a foreign operation represents a foreign currency net asset and if the foreign currency decreases in value against the U. S. dollar, a decrease in the U. S. dollar value of the foreign currency net asset occurs” (Hoyle, et al, pg. 477). With the current rate method, all income statement items that occurred at the exchange rate during the date of accounting recognition requires translation.

The temporal method “ produces a set of U. S. dollar-translated financial statements as if the foreign subsidiary had actually used U. S. dollar in conducting its operations” (Hoyle, et al, pg. 478). There are a set of rules that are consistent with this method such as: 1. Assets and liabilities that appear on the foreign entities balance sheet at historical cost are translated at historical exchange rates in order to equate to the U. S. dollar; and, 2.

Assets and liabilities that are at current or future value at the current exchange rate are translated to equate to the U. S. dollar. This method is <https://assignbuster.com/foreign-currency-transactions-and-issues-that-may-arise/>

somewhat similar to the cost method in that it ensures translated amounts from the subsidiary's stockholders' equity equates to amounts that were originated out of the investment from the subsidiary that was recorded on the parent's balance sheet. There is anticipation that that the parent company will actually carry the foreign operation's cash amounts, marketable securities, payables and securities on the balance sheet.

Since the current rate method and the temporal method have been used currently in the U. S. and other countries have utilized the International Financial Reporting Standards (IFRS) as a guideline to our GAAP. The combination has caused an effort to adopt exchange rates that are currently used for financial statement reporting.

Per our text, " the major issues in accounting for foreign currency transactions is how to deal with the change in U. S. dollar value of the sales revenue and account receivable resulting from the export when the foreign currency changes in value" (Hoyle, et al., pg. 412). In essence this issue is how the changes of the U. S. dollar affect accounts payable and the imported goods that have been purchased. There are market fluctuations that have a tendency to affect the rate of the U. S. dollar as well as the foreign currency. To clarify, if a U. S. Company sells a good to a company in Germany and they are given 30 days to pay for their purchase. During that time the exchange rate decreases and the U. S. Company has to account for the decreased value. Per our text, " FASB ASC 830-20 Foreign Currency Matters-Foreign Currency Transactions requires companies to use what can be referred to as two-transaction perspective in accounting for foreign currency transactions.

This perspective treats the export sale and the subsequent collection of cash
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as two separate transactions. Because management has made two decisions (1) to make the export sale and (2) to extend credit in foreign currency to the customer" (Hoyle, et al., pg. 412) which means the company needs to report the affects this transaction caused to income separately.

Foreign currency receivables that come out of export sales produce asset exposure to foreign exchange risk. When foreign currency appreciates, the U. S. dollar value for foreign currency assets increase and foreign exchange gains happen. When foreign currency depreciates a loss occurs in foreign exchange. Payables that come from foreign currency imports create a liability exposure. Foreign currency appreciation will cause an increase in the U. S. dollar foreign currency liability and a loss in foreign exchange occurs. The effects are the reverse if foreign currency depreciates.

Outside cash budget reports ought to be interpreted at the rate appropriate to transformation of a money for motivations behind profit settlements. The FASB trusts that this rate is more important than some other rate on the grounds that the announcing element's net interest in the outside element could be acknowledged as it were by changing over money streams utilizing this rate. On the off chance that utilization of this rate causes contrasts between the deciphered intercompany records of two elements, the contrast is treated as a receivable or payable in the solidified budget reports until settlement of the exchange. Such contrasts may emerge in occasions where agitated intercompany exchanges are liable to and deciphered utilizing inclination or punishment rates, while the remote money articulations are deciphered at the rate appropriate to profit settlements. ASC 830 is quiet about the conversion standard that organizations should use to decipher the <https://assignbuster.com/foreign-currency-transactions-and-issues-that-may-arise/>

remote element's capital records (for instance, regular stock and paid-in capital). In any case, it is verifiable in ASC 830 that these ought to be interpreted at authentic rates. This is important to achieve the end of the parent's speculation and the auxiliary's capital records while combining. Capital exchanges (such as profits and speculations) ought to be interpreted at trade rates on the date they are perceived by both the parent and auxiliary, which probably would be a similar date. Deciphered held profit under the present rate technique is the sum toward the start of the period give or take sums for pay, profits, and so on (Foreign Currency Matters).

Goodwill coming about because of a business blend, and any reasonable esteem acclimations to the sums doled out at the obtaining date to the benefits procured and liabilities expected of a remote substance, ought to be interpreted as per ASC 830-30-45, paying little respect to whether the buy bookkeeping modifications are pushed down to the obtained substance. Subsequently, these parities ought to be estimated in the practical money of the gained substance and consequently meant the revealing cash of the parent (if the practical money of the gained substance is unique in relation to the revealing cash) at the present conversion scale. Any subsequent interpretation modifications would be incorporated into total interpretation change (CTA), regardless of whether the equalizations were not pushed down to the books of the gained element.

Conclusion

Although, foreign exchange may be mind boggling, in the present global market there is a basic requirement for nearly everybody to comprehend remote trade more than ever. As the world continues to grow exponentially, there is a consistently improving probability that accountants will be required to address the issues related with the way that there are various monetary currencies utilized all around the world and that these foreign currency forms will have immediate effect on our reality in how we perform and account for those transactions on financial statements. We should almost certainly assess the impacts of, and effectively react to, changes in exchange rates as for our utilization choices, speculation portfolios, marketable strategies, government approaches, and other life decisions (both budgetary and something else). Additionally, there is an expanding likelihood that we will encounter foreign exchange rates in some shape or form. But being prepared in how to handle those situations are the building blocks in the accounting profession. One should utilize all the tools that have been provided in order to eliminate and/or curtail those issues that may arise during foreign market exchange.

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