

McDonald's pound exposure

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Firstly, McDonalds US base parent company has got three pound-denominated exposures arising from British subsidiary. McDonald US has invested in the British subsidiaries.

Secondly, McDonald US has given loan of ? 125 million. It receives a fixed percentage on the name of royalty on gross sales because of this loan. US accounting norms are noted about the immovability of the intra-company loan. The loan is termed as permanently invested by McDonald's-US. This makes it an equity capital and any foreign profit or loss is reflected only in the CTA account on the joint balance sheets.

The other option of stating the loan ' Nonpermanent invested' would credit or debit all profit or gains from the account of the parent company. This would therefore not have been such a good idea. (Eiteman)

McDonald's US base parent company had a number of British pound-denominated cash inflows through dividend distributions, royalties and principal and interest payments on intra-company debt. Outflows through cross currency swap enable it to pay pounds and receive dollars. Interest payments are now made in British pounds and the principal amount at the end of the agreement on the cross-currency swap is also in pounds.

This is a very successful method of cross country swap for regular basis. (Eiteman)

FAS# 133 would need that McDonald's mark-to-market the value of the outstanding swap on a regular basis, and state the resulting gains/losses Other Comprehensive Income (OCI). Marking-to-market a cross currency swap will likely result in very large transition in the value of the business

from period to period. As both interest rates and exchange rates change, long term swaps with large imaginary principals outstanding in the distant future will change significantly in value.

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OCI is a form of income which must be reported. Unstable movements will be seen if CTA is combined with current consolidated income. It is basically not the matter of earning, but suppose there are two different firms of whom the EPS is same, but one firms showed decline in its OCI as a result of marking-to-market hedge. This is similar as McDonald's case. So would the firm be punished by the market? McDonalds still continues to follow FAS #133 and still reviews the strategy of the hedge and accounting policies regularly. (Eiteman) Work Cited Eiteman. Mutinational BusinessFinance. India: PearsonEducation, 2007.