

# U.S. ACCOUNTING REQUIREMENTS

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- FASB 52 Requirements Overview
- FASB 52 Currency Exchange Rates
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## FASB 52: REQUIREMENTS OVERVIEW

The Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards 52 (FASB 52), *Foreign Currency Translation*, defines the U.S. generally accepted accounting principles (GAAP) requirements for foreign currency revaluation. The complete Statement can be found on the FASB website <http://www.fasb.org>.

U.S. GAAP requires that Financial Statements be reported in the Functional or Local Currency of each reporting entity. If the Transaction Currency (currency in which the transaction takes place) is not the same as the Local Currency, then the Transaction Currency must be revaluated into the Local Currency using the exchange rate on the key date specified during valuation. The difference between the original posting value and the revaluated amount value results in a financial gain or loss posting on the Financial Statement.

It is important to note that the legal definition of the Country Currency should be represented in SAP as the Local Currency. FASB 52 helps define the legal Local Currency.

## **SAP FOREIGN CURRENCY REVALUATION**

When a transaction posting occurs in a currency other than the Local Currency, both the Transaction Currency and the Local Currency get posted on the line item posting in SAP. If a Group Currency (a common reporting currency) is defined, then the Group Currency will be posted along with the Transaction Currency and the Local Currency. The exchange rate used to convert the currencies is that which is in the currency exchange rate table for the postings translation date. This translation date is normally the posting date, but another date may be specified. Assuming these currencies are revaluated on a date different from the translation or posting date, a Gain or Loss (depending on whether the exchange rate goes up or down) will occur and be posted.

FASB 52 requires that revaluation occur on all foreign currency items that are part of an asset or liability period-end balance. Every foreign currency open item is revaluated individually, and the total currency adjustment Gain or Loss is normally posted to a Financial Statement Profit and Loss (P&L) Adjustment Account. In SAP, the account that is being valued retains its original balance. The balance sheet currency valuation adjustment is posted to a balance sheet account associated with the original account. The original asset or liability account and the balance sheet adjustment account (with the currency adjustment posting) are reported in one item on the Financial Statement. The Gain/Loss posting is reported in Net Income for that period in the Financial Statement unless the transaction hedges a foreign currency commitment or net investment in a foreign entity. In this case, the Gain/Loss is reported in the Cumulative Translation Adjustment (CTA) account in the equity section of the Financial Statement.

## **FASB 52: CURRENCY EXCHANGE RATES**

Paragraph 12 of the FASB 52 (December 1981) states:

All elements of financial statements shall be translated by using a current exchange rate. For assets and liabilities, the exchange rate at the balance sheet date shall be used. For revenues, expenses, gains, and losses, the exchange rate at the dates on which those elements are recognized shall be used. Because translation at the exchange rates at the dates the numerous revenues, expenses, gains, and losses are recognized is generally impractical, an appropriately weighted average exchange rate for the period may be used to translate those elements.

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Paragraph 27a of FASB 52 (December 1981) states:

Foreign Currency Transactions—The applicable rate at which a particular transaction could be settled at the transaction date shall be used to translate and record the transaction. At a subsequent balance sheet date, the current rate is that rate at which the related receivable or payable could be settled at that date.

The interpretation of this requirement that some companies use is the following:

In order to be in FASB 52 compliance, balance sheet accounts with foreign currency postings (e.g., open payables/receivables) must be revaluated to the Local Currency using the exchange rate in affect as of the balance sheet date. Revaluation is normally run on a period-end basis as part of month-end close using at a minimum an average exchange rate method (spot rates are the preferred method).

P&L Accounts in a foreign currency, represented by revenues, expenses, Gains/Losses will use the spot exchange rate on the date those postings were recognized. If a spot rate is not available the average rate could be used.

If at all possible, use the spot rate when calculating the balance sheet and P&L account currency revaluation (Gain/Loss postings and currency translation from Functional Currency to Group Currency). Adjustments posted to CTA should be recorded similarly. SAP has many transaction codes that allow for updating the foreign currency exchange rates; OC41 is one of them.

The assumption is made throughout the book that the exchange rate varies from day to day (which it normally does). If, however, it does not fluctuate from the original posting date to the date in which Currency Revaluation is run, there will not be a currency revaluation posting difference.

Because realized exchange rate fluctuations can occur daily, exchange rates should be maintained or updated daily either manually or by an interface such as Bloomberg. It is highly recommended that the exchange rate updates be automated.

## SAP FOREIGN CURRENCY REVALUATION

### FASB 52: CURRENCY TRANSLATION

FASB 52 uses the terms *valuation*, *revaluation*, and *translation* interchangeably. For the purposes of this book, we will use “revaluation” to indicate the revaluation of the Financial Statements from Transaction Currency to Local Currency and “translation” as the Local to Group Currency adjustment process.

If the Reporting Currency of the Financial Statements is different from the Local Currency, then the Financial Statements must be translated from the Local Currency to the Reporting Currency at the exchange rate of the Financial Statement date (normally period-end). This is necessary to report the consolidated Financial Statements of an entire organization in a single currency. This is for internal financial reporting and does not affect the external financial reporting of a company. These translation adjustments are not included in the Net Income, but are reported in a separate component of consolidated equity with the sale or liquidation of the net investment that occurs in a foreign entity.

### ORGANIZATION IMPACTS

In order to be in FASB 52 compliance, balance sheet accounts with foreign currency postings must be revaluated to the Local Currency using the exchange rate in effect as of the balance sheet date. Revaluation is normally run on a period-end basis as part of month-end close using at a minimum an average exchange rate method (spot rates are the preferred method). Companies that required consolidated financial statements have different currency revaluation requirements. Companies that produce consolidated financials that have foreign currency postings must translate Local Currency postings into reporting currency. The impact to financial statements is discussed in high level as follows.

#### **Consolidated Financial Statements**

Local Currency balance sheets of consolidated foreign subsidiaries are translated according to their functional currency into the Group Reporting Currency at period end using key date exchange rates. The Income Statements are

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translated at annual average rates. Translation differences of assets and liabilities between the balance sheet and Income Statements do not affect income. They are included in Other Income in the consolidated statements in shareholder's equity. Foreign currency assets and liabilities are translated at period-end closing rates with Gains/Losses reflected in Net Income.

### **Net Income Impacts**

Currency fluctuations that affect cash flows are included in the calculation of Net Income. These would be the Gains and Losses resulting from the revaluation of components of assets or liabilities that originated from foreign currency postings. Gains and Losses resulting from normal short-term or immediate foreign currency intercompany transactions are also included in the Net Income for the period.

Consolidation results should not be included in the Net Income calculation. Long-term intercompany investments in a foreign entity are part of a company's net investment strategy (without immediate Gains or Losses) and should not be included in Net Income. Examples of investments that are not included in the Net Income are demand note payables and advances that are not immediately planned.

