Managing foreign currency challenges
Addressing economic and financial reporting risks

In an increasingly global economy, companies of all sizes and sectors operate in markets around the world. These operations present tremendous opportunities; however, they also create complexity for treasury operations and for financial reporting.

Operating in multiple currencies increases financial reporting complexity in several ways. For example, determining a foreign entity’s functional currencies isn’t always as straightforward as it seems, and determinations may need to be periodically reassessed.

Similarly, remeasuring foreign currency transactions and translating financial statements into a single currency can require sophisticated processes, producing results that can be difficult to explain to analysts and management not well versed in this type of accounting.

Understanding foreign currency challenges of foreign operations
Foreign currency exposure is a natural consequence of multinational operations, and currency fluctuations can affect the results of operations, the value of assets and liabilities, and cash flows. Global markets have seen unprecedented volatility in recent years, highlighting the necessity for robust programs that can mitigate enterprise risk.

We understand the challenges companies face in identifying and quantifying their foreign currency exposures, effectively managing these risks and properly reflecting foreign currency and hedging activities in the financial statements.

Through our deep understanding of the accounting, treasury and tax implications of various foreign currency mitigation techniques, we can advise you in the development and maintenance of a process to identify, quantify and manage your foreign currency exposures.

Identifying and trying to mitigate hidden exposures

Further, the risk from foreign currency exchange (FX) extends beyond what can be easily gleaned from financial statements. Future purchases of raw materials or sales of goods in a foreign currency are real economic exposures whose impact isn’t reflected immediately or clearly in financials.

An organization may have contracts with FX bands or price adjustment mechanisms that never appear in your accounting system as an FX transaction but are in fact exposing you to price volatility. You may even have contracts denominated in your home currency but subject to volatility because the counterparty is passing its FX risk through to you in terms of reduced demand.

Once exposures have been identified, most companies will seek to mitigate the potential volatility. One approach is to pass through the FX risk to customers or suppliers. However, this could hurt your relationship with customers or negatively impact the price you receive from suppliers. Another approach is to use financial derivatives, which can be a very effective tool but which come with their own complexities. Use of derivatives to mitigate economic risk can actually increase financial statement volatility if hedge accounting is not properly applied.

Routes to reduce risk

Foreign currency challenges can affect many parts of your business. A few items to consider:

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<tr>
<th>Policies</th>
<th>Do you have appropriate FX accounting and risk management policies in place that appropriately cover your business today but are also flexible enough to accommodate your business tomorrow?</th>
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<tr>
<td>Exposure identification</td>
<td>Do you have appropriate processes in place to identify and quantify FX exposures – not just forecasted transactions, but also hidden exposures? Does your reporting enable you to adequately explain this volatility to both internal and external stakeholders? Are you fully aware of natural offsets within the business?</td>
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<tr>
<td>Derivatives</td>
<td>Do you have appropriate processes and controls in place to address potential risk? If you apply hedge accounting, is your documentation sufficient, and are your processes efficient and sustainable? Are you aware of the different hedge accounting elections in the FX guidance and which elections would best achieve your hedge objectives?</td>
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For US companies, the long-term trend of the strengthening US dollar against many currencies is the undercurrent driving concern about translating foreign income. Companies across all sectors have turned to EY to discuss the complex issues that flow from doing business in a variety of currencies.

In some sectors, challenges arise from intercompany inventory sales from parent to foreign subsidiaries. In others, royalty flows from foreign subsidiary back to parent create uncertainty. In a number of countries, subsidiaries have legal and taxation obstacles to tackle before paying dividends up to the parent, which may exacerbate currency imbalances.

Additionally, the complexity of exposure identification, valuation of FX derivatives and the resulting hedge accounting tests are not easily accomplished without a technology solution.

Our professionals have a depth of experience and insight that can be important in helping companies recognize and reduce their exposure to volatile currency markets and the impact this volatility can have on financial reporting.

How EY can help

Are you looking to benchmark and improve your current processes for FX exposure management? Thinking about selecting and implementing an FX or treasury management system? Trying to design a new hedging program or optimize a current one? Or maybe you are contemplating the adoption of hedge accounting for the first time?

We have a team of professionals drawn from various backgrounds who can help you develop cost-effective and sustainable approaches to these challenges.

**We can:**

- Describe the current hedge accounting landscape and the pros and cons of applying hedge accounting, including observations on strategies and level of effort involved
- Provide training for the practical application of hedge accounting, including illustrative hedge documentation and journal entries for various foreign currency scenarios
- Perform a current state diagnostic of your FX exposure management process, helping you to identify gaps with leading practices, alternative approaches and future state opportunities to improve practices and structures

**We can advise and provide input on your:**

- Assessment of functional currency identification and conversion
- Foreign currency risk management policies and procedures
- Evaluation of FX risk management/treasury management systems
- Evaluation of strategies and tax consequences of various approaches to containing, shifting and hedging FX risk
- Acquisition of a technology solution to help with exposure and consolidation and the recording of corresponding hedging strategy and accounting entries

Other treasury issues

Working in the area of FX is just one way in which we can help you manage risk, and you may benefit from our insights across the full spectrum of treasury issues.

Other areas in which we may be able to advise you include treasury transformation and organization design, technology selection and implementation, global cash management, cash flow forecasting, financial governance and regulatory issues, treasury integration and carve-out support.