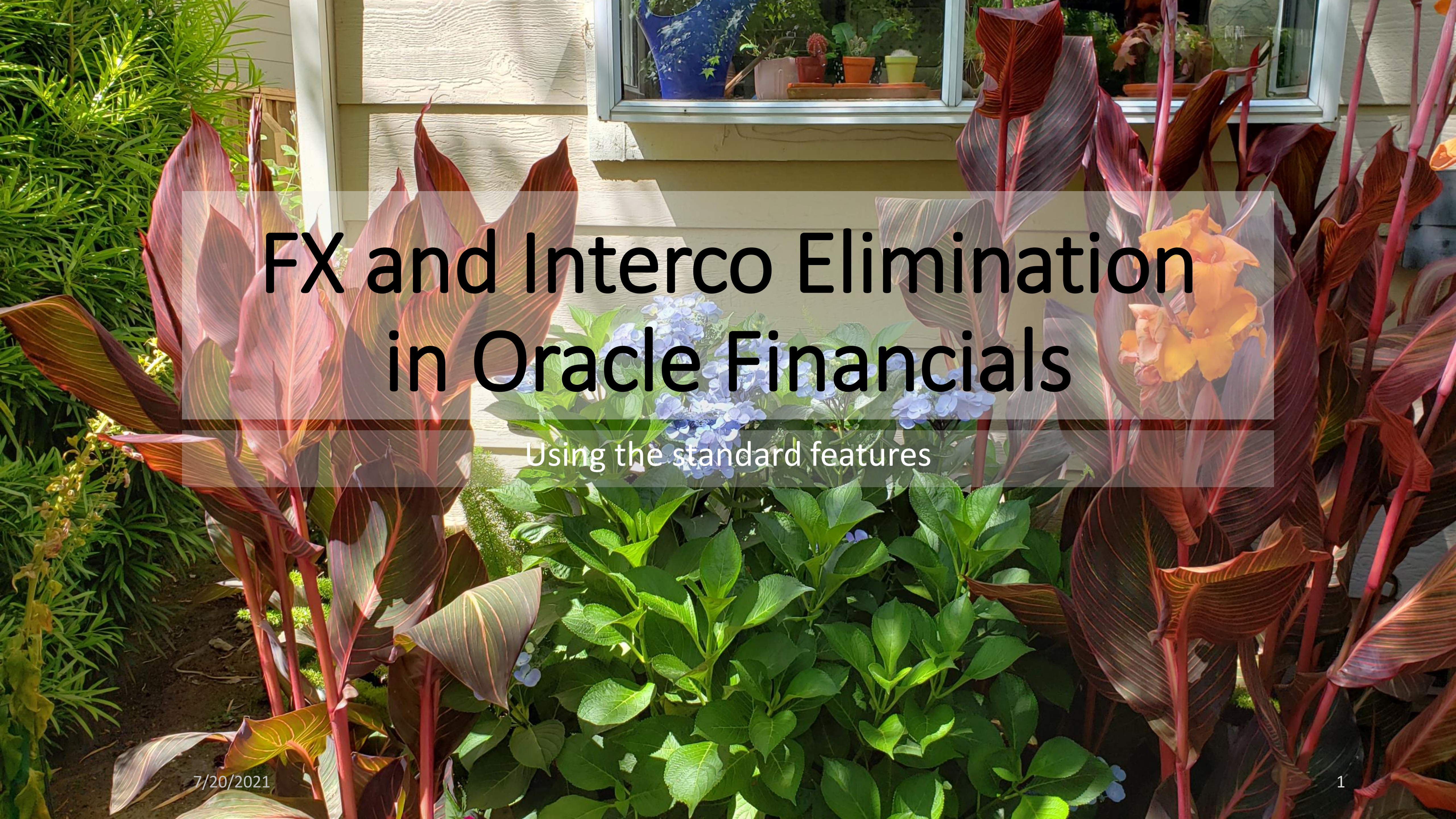

FX and Interco Elimination in Oracle Financials

Using the standard features

Agenda

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Client Question & Background

The Client Requirement

- UK Ledger implementation for a NY client.
- Adopt 830: USD be the ASC 830 Functional Currency
- Elected to have GBP be the accounting (Oracle functional) currency.

- They have a requirement (and it is consistent with 830) to treat Intercompany in the same way as they do equity, translate at the average rate not the PTD end rate.
- You can override default treatment of accounts in FCCS to achieve this, but I don't see a way to do this in Cloud ERP.
- This requirement exists when they won't be settling intercompany each month and they will instead treat it as a longterm investment.

FAS 52, ASC 830 & ASC 812.

- July 1, 2009: All FASBs and other US GAAP documents then in force (EITFS, SOPs, et cetera) were incorporated into the FASB's "Accounting Standard Codification"™ and reorganized in a logical rather than historically sequenced order.
- FAS 52, for the most part, became ASC 830, and covers "translating the results of foreign operations", that is, currency matters.
- ASC 812-20-45-1 (Consolidation) requires that intercompany transaction be "eliminated" in their entirety. When they do not appear anywhere on the balance sheet or income statement (that is, when they do show as net zero), they are OK.

More on Intercompany in general

- Intercompany transactions update the legal ownership of assets & liabilities between companies (LEs) in your group
  - They can be in respect of goods and services. Goods includes inventory and fixed assets. Services include royalties, expenses, expatriate salaries, shared services, costs, allocations, and many other categories
  - Intercompany transactions include cash: settlements, disbursements, dividends, loans, debt assignment, and similar
  - Intercompany is a true sale and purchase, and exposes the entities to possible transaction tax (sales tax, VAT, GST, et cetera) are profit mark-ups when it crosses tax authorities
- Intra-company updates the managerial responsibility rather than the legal ownership – transfers of goods and services from division to division, from factory to the sales org., from project to project, from branch to branch. Alone, intra-company is a reclass, not a formal transaction
  - Possible transaction tax exposure is limited to use-tax at cost (unless it is also intercompany, i.e., inter-intra).
- Both must net to zero on the Group accounts
- There are many considerations in addition to currency in ensuring that intercompany eliminates
  - Dispute process
  - Defined date and time
  - Defined ownership responsibility, defined in trading terms agreements & INCO terms

Implication at the Client

1. The client's requirement to show the intercompany in Equity is not a US GAAP requirement. US GAAP wants the balance to be zero dollars - not to appear anywhere.
2. However, they may have another requirement, such as a local statutory (corporate law) or an IRS tax requirement on one or both of their subsidiary companies (legal entities) individually.
3. Or wish to have externally reported only assets & liabilities included in equity at all entities; or as in the later example, have value added to their investment in subsidiary
4. The key requirement for currency management is to ensure that two subsidiaries involved use the same rates as each other both in recording the receivable and payable, and in translating to either ASC 830-functional currency or ASC 830-reporting currency, so that the net balance does appear as zero dollars.
    1. Use the same current rates, eliminate at current rates: net to zero
    2. Use the same average rates, eliminate at average rates: net to zero
    3. Use the same "constant $" rates, eliminate at "constant $" rates: net to zero

Practice Governance Guidance

Practice: Governance guidance #1
Define the intercompany invoice currency

1. The client must be firm in denominating the intercompany document in one currency or another: no disputes about which at the intercompany party level.
   a. Each transaction-pair has **one** denomination currency.
   b. Many people like “corporate currency”.
      a. Disadvantages:
      b. Exposed to noticeable (false precision) rounding errors in the conversion to foreign and translation back to corporate process, and it
      c. Monetary exposure appears fixed at corporate while remaining exposed at the sub.
   c. Others like “subsidiary currency”, because it moves the FX exposure to corporate.
   d. Many use the currency of the original transaction
2. Point is, through, both parties must enter the denominated amount in the entered column of Oracle GL (unless the denomination currency is the also their accounting currency.)

So, the FX rates change

- FX Rates change all the time: many times per hour.
- How can a person tell which is the right rate to use. It might go up again tomorrow?
  - Read ASC 830, or its IFRS twin, IAS 21. (Both written in part by Mr. Tom Jones.)
- The ASC 830 rate to use is, only:
  - the (a) cost of foreign currency to you (b) on the balance sheet date: the current rate.
  - when recognizing non-functional currency non-monetary assets or liabilities, (c) the rate on the day of recognition of the asset or liability (historic rate) ("remeasurement")
  - When booking income, (d) the weighted average current rate for the period being reported
- Functional currency is the currency of a business. Some businesses are worldwide, and then, that means home currency. Others are local, and then, that means local currency.
- Reporting currency is the currency of your Corporate filing to your equivalent of the SEC
- FX expense is the cost of holding foreign money as the rates change over time: balance times (opening rate minus closing rate)

Practice: Governance guidance #2

Know the cost of foreign currency to you

1. The client must be firm in the month end and any average rates used.
   a. This remains true if they are using an average rate as a month end rate (more later)
   b. The client must figure, in Treasury at Corporate, cross rates to the ASC 830 Reporting Currency for each of the currencies involved – the documentation denomination currency, and the accounting currency of the both subsidiaries, and publish those rates to the subs.
      i. No arguments; the client is not a democracy but a public company ☺
      ii. Respect legal needs: if they are consolidating from "Local First" ledgers, use the legally required rates, and adjust the consolidation. Book the legal-GAAP difference to "cost of banking" in that country – it is not FX.
   c. The client must be firm about using the rates used in the cross-rate calculation to do the ASC 830 Translation or Remeasurement, or IAS 21 Translation.

Practice: Governance guidance #3

Bookkeep foreign currency interco in the entered field

- The client must be firm about using GL Revaluation to revise the intercompany balance to the correct accounting currency valuation in each subsidiaries ledger at the cross rates published in 2b.
- To do this, they must bookkeep the transaction in the denomination currency of the transaction in the Entered currency column of GL, and let Oracle figure the Accounting Currency value at the current daily rate.
- GL Revaluation, working on the denomination currency, and pointed towards the intercompany account, will figure the value at the month end rate, and book the difference to FX in the Accounting currency, updating the GL Accounting currency balance

Settlement

- Balances on Intercompany Receivables & Payables will need to be dispositioned
  - Trading accounts – movement of inventory and routine services – will need to be settled. The supplier will need to be paid.
  - Investments in a subsidiary of fellow subsidiary will need to be written to capital. This may be a formal injection of cash, or it maybe forgiveness of a trade account.
  - Loans and notes will need to be settled as scheduled.
  - Repatriation of profits through dividends or remittances may occur
- Some are still settled invoice by invoice: some countries insist on this
  - But most are paid in groups – such as the previous month end's balance
  - Or on collection of a customer's payment (pass through)
  - Many other models

Practice: Governance Guidance #4

Always settle in the denomination currency

- Currency wise, remember that the intercompany balance is “exposed” as an FX balance on one of the LE’s trial balances
- So arrange its settlement it in its denomination currency
  - If you used several denomination currencies, make several settlements
  - Example: NYC HQ-Germany - USD for factory goods, INR for SSC fees, EUR for software service credits: make 3 settlements, USD, INR, and EUR.
- If you don’t, the entered currency amounts will not be cleared, and will remain included in your FX exposure calculations. (At Oracle, this is GL Revaluation)
- When you do use the denomination currency, the settlement will wash with the invoices you are settling, reducing their exposed balance to zero. Then GL Revaluation will figure zero times the month end rate after settlement and will produce an FX adjustment to bring the accounting currency value to zero too.
- You can book the actual settlement at the bank rate: and difference will be offset in the GL revaluation entry. However, to get the realized gain and loss to equate with each other and to offset, both control that the settlement is booked at treasury cross rates, and book the difference to the bank rate to “bank charges” or similar.

Client Specifics

The client wanted an average rate

- The client needs to publish the “average rate” in their rates table, as the rate to use for the month end equity accounts. This is similar to populating and accessing historic rates on say, inventory accounts, when doing ASC 830 Remeasurement.
- GL supports rate tables, plural. They are by currency, and by various types of rate.
- You can buy updates from external companies like banks.
- You can use third party tools like FXLoader.
- You can figure cross-rates and weighted historic average and loads them with Excel or FBDI.

Client Question: Equity Accounts

- Oracle translation correctly carries forward equity accounts – capital and retained earnings – at their original rates, plus activity (new capital, dividends, current year earnings) at the appropriate historic, incremental rates
- So if the client wants their intercompany to be in equity:
  - Do *not* classify the intercompany as equity to the Translation program - it will treat them like it does share capital
  - Instead, do create an Equity parent account and roll them up to it
  - Technique for the currency:
    - Create a new currency, e.g. “USN” or “US2” in the rate tables
    - Populate a rate table with the desired cross rates to that currency
    - Tell Revaluation or Translation to use the desired cross rate in that currency
- The offset to the intercompany might well be a permanent equity account.
  - I wonder if the client was deliberately generating an OOB intercompany situation for this reason

Use Case

Case Study: given facts

See associated spreadsheet

Intercompany Investment
Valued at Average Rates
Eliminated on Consolidation

Example:
US HQ pays European (EuroZone) IT firm €1,000 (EUR) to excetute modernization of UK IT system, and bills the UK at cost.
No settlement is planned: is seen as an investment, and booked to equity on both sides.
Policy is that equity is booked at average rates.
UK sub maintains books in GBP (£).
US Corp maintains books in USD.
Group is US, Reporting Currency is USD.
Functional Currency of all entities is USD.

Cross Rates

Exchange Rates			
			Derived
Date	USD-EUR	USD-GBP	EUR-GBP
Spend Date	1.2164	0.71070	1.7115
Monthly Average Date	1.3380	0.81731	1.6371
Monthly Close Date	1.1556	0.75192	1.5368
Monthly Equity Rate	1.3988	0.83507	1.6751

Spend date is today's, other are fictional, a random % points up and down

Capital Investment at Equity rate			
1000	714.87	714.87	596.97

Published by Corporate (Treasury, Intercompany, Controllership)

Journal Entries

All figures in Millions	Books of US Corp				Books of UK Sub				
	Entered Currency		Accounting Currency USD		Entered Currency		Accounting Currency GBP		
Entries									
AP (Consulting) @ Spend Rate		€1,000.00		$822.10					Regular AP
IcoInvest @ Spend Rate	€1,000.00		$822.10						
GL Reval AP to Month End Rate				$43.27					Regular AP Revaluation
Unrealized FX Expense			$43.27						
AP is 1000@1.1556=$865.37									
GL Reval IcoInvest to Average Equity Rate				$107.23					One time set up on the "investor side" to set the interco to the equity rate.
Unrealized FX Gain			$107.23						
IcoInvest is €1000 at 1.3988=$714.87									
HQ Investment in UK at spend date						€1,000.00		£584.27	
Capital Investment at spend date					€1,000.00		£584.27		
GLReval IcoInvest at Average Equity Rate								£12.70	One time set up on the "investee side" to set the interco to the equity rate.
Unrealized FX Expense							£12.70		
IcoInvest is €1000 at 1.6751 = £596.97									
One Time GLReval IcoInvest at Average Equity Rate							£12.70		This one is not germaine, but is likely
Unrealized FX Expense								£12.70	This could be expense at mid month rate; inventory at historical rate, etc.
IcoInvest is €1000 at 0.83507 = £835.07									One time only because equity is "historic", changed only on P&L numbers.

Denominated in EUR

Extended TB, Translation & Consolidation

All figures in Millions	Books of US Corp					Books of UK Sub							Group Consolidation	
		Entered Currency		Accounting Currency USD			Entered Currency		Accounting Currency GBP		Translation to USD		Reporting Currency USD	
	Currency	Dr.	Cr.	Dr.	Cr.	Currency	Dr.	Cr.	Dr	Cr	Dr.	Cr.	Dr.	Cr.
AP (invoice)	EUR		€1,000.00		$822.10 $43.27								$0.00	$865.37
Intercompany Investment	EUR	€1,000.00		$822.10	$107.23	EUR		€1,000.00		£584.27 £12.70		$714.87	$0.00	$0.00
Capital Invested						EUR	€1,000.00		£584.27 £12.70		$714.87		$714.87	$0.00
Unrealized FX Expense				$43.27 $107.23					£12.70	£12.70	$0.00		$150.50	$0.00
TCA Capital & PY Income Current year Income Et cetera														

- The trade AP (€1000) is translated at the current rate ($865.37)
- Intercompany Investment receivable & payable (€1000-€1000) are eliminated, both at the average equity rate ($714.87-$714.87). Both were revalued to that rate.
- The capital invested (€1000) is reported at the average equity rate ($714.87)
- Foreign Exchange Gain/Loss is reported at $150.50 between the spend date and the recognition (mth/ ave.) date.

Taxonomy

Taxonomy

Phrase	Meaning in GAAP/IFRS	Occasional Meaning in Oracle (Many Oracle people use them as they are used in GAAP, some don't.)
Functional Currency	The currency of a worldwide business: "The functional currency of our manufacturing group is USD worldwide." vs. "The functional currency of our worldwide service business is always the local currency."	The currency in which a software ledger functions. Also called the "accounting" or the "ledger" currency. Often is the GAAP/IFRS functional currency, but often, is not.
Reporting Currency	The currency of your external reports (Annual Report, 10K, 10Q, etc.)	The currency of a report, any report.
Historic Rate	The rate on which a non-monetary, non-functional currency denominated amount was converted to functional currency as of the date of recognition.	The daily rates table.
Intercompany	Update of the legal ownership attribute of an asset (cash, invoice, item, investment, intangible, and so on) or liability or revenue or expense on a transfer of goods and services between legal entities under common ownership.	Any inter-org transfer: intercompany, intracompany, cross-(Oracle) Business Unit, cross-org, cross-balancing segment, processed in AGIS, handled by an intercompany feature, et cetera.
Entered Currency	N/a	A field in the sub- and general- ledgers to accommodate currencies other than the ledger currency. Has many currency management features associated with it. Requires balanced entries.
Denomination Currency	ASC 830: The currency in which you intend to settle. Contract Law: The currency specified on the document.	Not used.

Thank you