The FX problem

Foreign currency management can be complex and challenging. Good system and process setup reduces a lot of the common problems

The accounting system:

Choosing a true multicurrency accounting system* makes managing FX considerably easier than a single currency system. The system cost is higher but this will be offset by staff savings during ongoing & year end work.

Reporting

If you have reasonable foreign currency exposure, we suggest that you update your reporting currency rates at least monthly to enable an accurate reporting on performance. This reduces surprises at year end and can be important if you have banking covenants to meet.

Setting up and maintaining currency in the system is equally important. P&L should be expressed at transactional rates but for practical purposes, the monthly average rate is often used. The balance sheet uses the spot rate uploaded each month. Hedged rates should be used where applicable.

Who takes the FX risk—central or decentralised?

The structure of your intercompany contracts and what currency is used determines which entity in the relationship bears the admin and risk of managing the currency.

For practical purposes, the central or holding company usually bears the risk as they usually have a more sophisticated finance/treasury team. This team also has a better overview of risk and currency flows and therefore better positioned to hedge the risks as applicable. Make sure your intercompany balances are treated as per the intercompany contracts.

Hedging

Hedging is a useful tool to reduce risk and uncertainty. The finance team will need to work out the cash flows in currency and then hedge accordingly.

We suggest that you set up clear parameters and ensure that the board have signed up to these prior to undertaking this activity.

Approaches can vary from basic forward contracts to significant use of options and other instruments.

emersonnash

*multicurrency system = transactions held in separate currency tables in the underlying database