

Accounting Volatility:

The hidden impact of multicurrency accounting data, systems and processes on foreign currency exposure and risk

NOTE: the following document provides a summary of the complete white paper. To download a free copy of the full document, go to:

<http://www.fireapps.com/download/whitepapers>

Executive Summary



Introduction

When it comes to foreign exchange, the more things change, the more they remain the same. Over the past two years, the dollar has weakened dramatically. Volatility has been high. European and Asian companies have struggled to manage the negative impacts of the strength of their currencies compared to the US Dollar. U.S. firms have been asking themselves whether they should be hedging. Regulatory bodies have discussed changing disclosure requirements. All of these things are as true today as they were back in 1980.

Of course, after 1980, things changed. The dollar regained its strength. Many stakeholders who took their eyes off the fundamentals in the late 1970s were unprepared for changes in the early 80s that led to serious economic consequences. Then, as today, the dollar's weakness had obscured some underlying problems.

In 1980, economic impacts drove regulatory bodies to do what they often do after a crisis in confidence: increase scrutiny on stakeholders. This led to the introduction of FAS 52 in 1981 and increased disclosure requirements. If current trends follow suit, the eventual rise of the dollar will be marked by economic losses and potential financial restatements by U.S. multinationals, followed by increased stakeholder scrutiny and in the worst case, another round of regulations. As we stand at the precipice of a similar trend, multinational companies today need to ask themselves how well they are prepared to expose their own multicurrency accounting processes to similar scrutiny and pressure from market forces.

This whitepaper focuses on the problems faced by multinational companies today who struggle with multicurrency accounting issues that seriously undermine their ability to quantify their foreign exchange exposure. Today, for most U.S. companies, the impact of this problem has been mitigated by the weakness in the U.S. dollar relative to foreign currencies. When this trend ultimately shifts, however, companies that have not accurately identified and quantified their FX exposure, and subsequently managed their FX risks, will be faced with serious economic and compliance consequences.

As you'll see from the following overview, we've identified the most common sources of multicurrency accounting problems, described the symptoms of these problems, and proposed proactive steps that companies should take to better insulate themselves from foreign currency volatility.

Overview and Highlights

Better Data=Better Decisions

- In a survey of 100 FX practitioners conducted by FiREapps, nearly 50% expressed concern or lack of confidence in FX exposure data, while one third expressed marginal confidence in the data they receive from accounting.
- The real problem highlighted by these survey results is that, essentially, treasurers and controllers alike *don't know what they don't know* about their foreign currency exposure data. All too often, the first symptom of a problem shows up as a material misstatement of FX gain/loss with serious consequences.

*" As our business evolved as a result of acquisitions, organic growth, tax requirements, I assumed for years that Accounting and Finance IT were updating our Oracle system to properly reflect the new multi-currency accounting requirements...
I was wrong."*

*Director International Treasury,
Fortune 500 Software and
Services Company*

- FiREapps has coined the term **accounting volatility** to define the phenomenon of off-setting errors and omissions that distort foreign currency data, falsely masking the true exposure in ways that make it difficult to detect. The problem is pervasive in multinational companies today, and needs to be addressed proactively, before significant economic and compliance impacts are experienced.

Common Sources of Accounting Volatility

- Sources of accounting volatility fall into two main categories: **accounting and organizational issues**, and **system and configuration issues**.
- The biggest **accounting and organizational issue** that impacts accurate FX exposure calculation is manual accounting processes. The improper recording and relief of a transaction, and improper, unilateral recording of intercompany transactions are two prevalent sources of error that can seriously distort a company's exposure.
- FX-related **system configuration, administration and maintenance issues** in most major ERP systems result in inconsistent revaluation of accounts across the enterprise. Examples of accounts that should be revalued but are not, and accounts that are being revalued, but shouldn't be, are widespread in companies relying on today's most popular ERP systems. In most cases, companies are unaware of the problem.

Accounting Volatility Symptoms and Solutions

- Accounting volatility can be difficult to detect, but there are symptoms to look out for. There are four basic questions that an organization can ask to determine the extent of accounting volatility within its FX exposure management operations:
 1. How confident is your Controller that multicurrency transactions are being recorded properly including initial entry of the transactions as well as clearing of the transactions?
 2. When was the last time the Controller reviewed enterprise wide revaluation to determine if the system(s) configuration and related processes produced a result that complied with FAS 52?
 3. How confident is accounting that intercompany transactions are being reconciled on a timely basis and are in balance?
 4. Does the Controller perform foreign currency gain/loss analysis on a regular, monthly basis and maintain a proactive process for the resolution of exceptions?

Foreign Exchange as an Enterprise Risk

- While Treasury is often viewed as the FX process owner, they are only one piece of the puzzle. Different groups within any organization contribute to foreign currency exposures, and to the steps involved in managing those exposures.
- The only way to ensure tighter coordination and greater visibility of foreign exchange risk is to acknowledge foreign currency volatility as an enterprise risk, and to assign the proper level of oversight, accountability and resources to the entire process.

Next Steps

- To download a complete copy of this whitepaper, go to <http://www.fireapps.com/download/whitepapers>
- CFOs, Treasurers or Controllers can turn to FiREapps and its partners to provide expert consulting and analysis of their foreign currency exposure management processes, and to accurately quantify their FX exposure.
- Companies who have identified FX-related accounting or exposure management issues can rely on FiREapps to provide a solution to remediate any sources of accounting volatility and inaccuracy, and provide software applications, tools and consulting to monitor the effectiveness of their programs on an ongoing basis.
- Companies who believe that they have adequately addressed their multicurrency accounting processes and their FX exposure management policies can benefit from FiREapps software applications by automating and institutionalizing processes, improving their effectiveness while lowering the costs of their FX exposure management program.

To learn more, contact FiREapps by phone at +1 866-928-FIRE (3473) or via e-mail at impactanalysis@fireapps.com.