
How Do You Handle Foreign Currency Transactions? (Or a little accounting homework)

With the advent of free trade and more generally globalization, even small businesses have begun to trade with foreign business partners.

The accountants began to invent all sorts of methods for entering foreign currency transactions into computerized accounting systems that had not been designed for this purpose. These methods worked somehow as long as we had to recognize only the USD dollar. But when we began to trade in other currencies, these management tips, simple at first, quickly became a nightmare to apply.

We suggest here a method that is easy to implement and to follow and, in addition, is correct for accounting purposes.

First, some basic assumptions:

- For this purpose, we will use the Canadian dollar as the base currency: CAD\$.
- Only balance sheet accounts should reflect changes in exchange rates over time.
- Income statements, in turn, must reflect the value of the transaction in CAD\$ at the rate prevailing at the time of the transaction and no longer change.
- Exchange rates vary so often (but so little) that we need an applicable method even if we do not vary the rates for calculations every day! The method must, however, be flexible enough to recognize that a sales transaction (for example) may be recorded at one rate but paid a few weeks later.

If you agree, let's continue...

Let's add to our chart of accounts a so-called « conversion » account for each balance sheet account that has to support a foreign currency. Let's put this account in the chart immediately after the base account. The purpose of this account is to bring back in base currency, in this case Canadian dollar, its base account expressed in foreign currency (And that's it for the financial statements!).

For example, consider a company with a CAD bank account, a USD bank account, and a client account in USD Currency. We would end up with a partial chart as follows:

GL	Description
1000	Bank CAD\$
1100	Bank USD\$
1101	Bank Conversion USD\$
1300	Account Receivable USD\$
1301	Account Receivable Conversion USD
5000	Income (Sales)
9000	Exchange Gain or Loss

Now let's look at the recording of transactions and their effect at the balance of verification. (We are the 1st of the month and the exchange rate is 1.50)

Registration of a \$ USD Sales Transaction valued at \$ 100 USD:

5000	Income	150.00	CT
1300	A/R USD\$	100.00	DT
1301	A/R Conversion USD\$	50.00	DT

Registration of a partial deposit of \$ 40 USD on the 10th of the month. The rate is 1.48:

1100	Bank USD\$	40.00	DT
1101	Bank Conversion USD\$	19.20	DT
1300	A/R USD\$	40.00	CT
1301	A/R Conversion USD\$	19.20	CT

The balance of verification is now read as follows:

GL	Description	DT	CT
1100	Bank USD\$	40.00	
1101	Bank Conversion USD\$	19.20	
1300	A/R USD\$	60.00	
1301	A/R Conversion USD\$	30.80	
5000	Income		150.00

At the end of the month the USD is trading at 1.49. Let's do the monthly posting that will adjust the balance sheet accounts.

1101	Bank Conversion USD\$	0.40	DT
1301	A/R Conversion USD\$	1.40	CT
9000	Exchange Gain or Loss	1.00	DT

We arrive at the next final BV:

GL	Description	DT	CT
1100	Banque USD\$	40.00	
1101	Bank Conversion USD\$	19.60	
1300	A/R USD\$	60.00	
1301	A/R Conversion USD\$	29.40	
5000	Income		150.00
9000	Exchange Gain or Loss	1.00	

Conclusion

The suggested approach has significant benefits:

- Currency account shows transactions without any manipulation.
- We can at any time have a correct idea of the value in Canadian dollar of our balance sheet accounts.
- It allows (by the calculation of the gain or the loss on rate variation) to release to the income the consequences of having assets in foreign currencies.

We have automated this recording method with **DCision ERP**. The user only has to choose the currency of the document to be registered and any registration to the conversion accounts is done automatically according to the exchange rate of the currencies then in force. It is therefore possible, even trivial to assign in the same registration multiple accounts attached to different currencies