To help preparers of financial statements and their auditors with Accounting Standards for Private Enterprises ("ASPE") Section 1651, Foreign Currency Transactions, we’ve summarized the key aspects of the section and offer relevant practical considerations for private mid-market companies through five commonly asked questions.

**Question 1:** Which exchange rate(s) should my reporting entity use to calculate and report foreign currency transactions?

- For monetary items, which include money or claims to money, use the exchange rate in effect at the balance sheet date.
- For non-monetary items such as inventory and long-lived assets and related amortization, use the exchange rate in effect on the date of the transaction.
- For revenue and expense items, use the exchange rates in effect on the date the items are recognized into income. The use of average exchange rates or other methods of approximation are acceptable.

**Question 2:** Is there a different method for translating transactions of the parent or reporting entity versus translating financial statements of a foreign operation?

- It depends. Foreign operations are classified into two types: integrated and self-sustaining. In general, the distinction is that self-sustaining operations are operationally and financially independent of the parent (i.e. reporting entity), whereas integrated foreign operations are not. The classification of a foreign operation as integrated or self-sustaining is primarily dependent upon whether the reporting entity is insulated from changes in exchange rates at the foreign operation level. Section 1651.10 provides further application guidance for management.
- Below are the two translation methods:

<table>
<thead>
<tr>
<th>Current rate method</th>
<th>Temporal method</th>
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<tbody>
<tr>
<td>The reporting entity uses this methodology to translate the financial statements of a self-sustaining foreign operation.</td>
<td>The reporting entity uses this methodology to translate its foreign currency balances and transactions, as well as translating the financial statements of an integrated foreign operation.</td>
</tr>
<tr>
<td>All assets and liabilities are translated at the exchange rate in effect at the balance sheet date.</td>
<td>Monetary assets and liabilities are translated at the exchange rate in effect at the balance sheet date. Non-monetary assets and liabilities are translated at the exchange rate in effect on the date of the transaction, i.e. historical exchange rates.</td>
</tr>
<tr>
<td>Gains and losses, resulting from the translation of the financial statements of self-sustaining foreign operations, are reported in a separate component of equity in the consolidated financial statements of the parent.</td>
<td>All foreign exchange gains and losses are reported in net earnings, including those resulting from the translation of the financial statements of an integrated foreign operation.</td>
</tr>
</tbody>
</table>

**Question 3:** Will entering into foreign currency transactions have an impact on our earnings?

- Yes. Changes in the exchange rate between the date of a transaction, such as a purchase or sale, and the date of the balance sheet or the date of settlement of the payable or receivable will impact earnings.
- Foreign exchange gains and losses arising from the translation of the financial statements of a self-sustaining foreign operation in the consolidated financial statements of the reporting entity would be recognized in a separate component of equity. Consequently, the classification of a foreign operation as self-sustaining or integrated could have a significant impact on the consolidated earnings.
How are foreign currency transactions presented and disclosed in the financial statements?

- The balance sheet presents all assets and liabilities at their translated amounts.
- Entities have the option to present a separate line item for foreign exchange gains and losses within the statement of earnings, or disclose the amount of gain or loss in the notes to the financial statements.
- The summary of significant accounting policies should include a policy for foreign currency transactions and the translation method of foreign operations.
- The impact on cash balances solely due to changes in exchange rates is not a cash flow. The effect of these changes, however, is reported in the statement of cash flows in order to reconcile the cash balance at the beginning and end of the period.

Many entities now use forward contracts to fix cash flows on foreign currency transactions. Would my company be a good candidate for the use of these derivatives?

- Engaging in hedging activities is a management decision, made to address risk. Careful consideration should be given as to whether hedging is consistent with the entity’s overall strategy to achieve its objectives. Moreover, a thorough understanding of derivatives should be obtained prior to entering into such agreements as hedging does not guarantee positive outcomes.
- Refer to Section 3856, Appendix A - Hedge Accounting for further information on accounting for forward contracts and other derivative financial instruments.

Certain other complex foreign currency transactions — such as elimination of intercompany profits, non-controlling interest, preference shares and lower of cost or market calculations of foreign operations — are also provided for in Section 1651.

To learn more about these items or for application guidance, please contact our Private Mid-Market Practice at privatecompanyinfo@ca.ey.com.
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