



January 13, 2020

Agenda Request
FASB
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Thank you for the opportunity to make an Agenda Request. My comments relate to a common hedging strategy that does not qualify for hedge accounting: hedging the foreign earnings of a corporation that has functional currencies that differ from the entity's reporting currency. I have previously sent in a comment letter, *Hedging Foreign Earnings – Is it Time to Obviate Translation?* In this comment letter, I would like to suggest an alternative approach. Instead of eliminating the concept of functional currencies, would the FASB consider allowing multinational corporations the ability to **make an election to use their reporting currency as their functional currency for all of their foreign operating subsidiaries?** If the reporting currency was the functional currency, there would be no translation and all highly probable forecasted foreign currency exposures could achieve hedge accounting.

Currently, the hedge accounting rules allow the hedging of a net investment in a different functional currency than the parent's functional currency. However, the more relevant foreign currency translation exposure for multinational entities is the desire to hedge the forecasted net income as this exposure will impact current earnings rather than equity, which is where a net investment hedge is recorded. A hedge of foreign currency earning translation is not currently allowed as the hedged item is viewed as an exposure of a dissimilar portfolio of income and expenses items.

As discussed in my prior comment letter, a common theme contained in many quarterly earnings calls and discussions has been the negative impact of foreign currency headwinds. Without a hedge accounting solution, many multinationals elect not to hedge this exposure as the hedge would be revalued through current earnings without an offset that relates to the change in the foreign earnings hedged.

When providing the initial FAS 52 guidance on foreign currency transactions, the FASB observed, **"If a foreign entity's functional currency is the reporting currency, remeasurement into the reporting currency obviates translation."** An election to change to a single unit of measure would eliminate the process of translating foreign subsidiary financial statements; then, all probable forecasted currency exposures (transactions not denominated in the reporting currency) could potentially qualify for hedge accounting.

Eliminating the functional currency concept of FAS 52 would be a significant change, especially for smaller corporations without the resources to institute a change of this magnitude. However, as the global economy and centralized treasury management trends continue to evolve, an election that would allow entities to use their reporting currency for all of their foreign currency operations is worth considering. It would also eliminate many of the unusual accounting results that certain FASB Board members raised prior to issuing FAS 52 and that I outlined in my prior comment letter.

Reasons to Eliminate Translation

1. The functional currency approach attempts to measure results in the primary economic environment in which an entity operates. Many public, multinational corporations manage their business on a global basis through a central treasury operation; a trend that continues to expand. As the FAS 52 dissent suggests, there was no persuasive reason to support the belief that external users want or need to know the amount of gains or losses as measured from the perspective of the manager of the foreign operation.
2. For investors and creditors, a single unit of measure would better assist in assessing future cash flows.
3. Individual assets and liabilities are subject to exchange rate risk rather than the parent's net investment. When exchange rates change between the reporting currency and a foreign currency, the value of any holdings of that currency changes, and from a reporting currency perspective, the resulting gain or loss is real. Functional currency accounting can result in a division of the gain or loss into one component that is considered in measuring net income, and the other that is considered as an equity, translation adjustment.
4. Real foreign currency gains and losses from translation can be deferred indefinitely.
5. Comparative financial results would improve with a single unit of measure.

Driven by technology advances and efficiency objectives, multinational corporations continue to centralize their treasury activities. Many multinationals have seen the benefits of centralizing policy setting, decision making and transaction execution. Also, there can be significant benefits for managing financial risk on a centralized basis. Under the single currency approach, a US reporting company's operating performance would be measured in dollars which is of primary importance to investors and creditors because that is the currency in which the enterprise ultimately makes and receives cash.

Under functional currency accounting, transaction gains or losses in earnings result from converting non-functional currency transactions into a foreign subsidiary's functional currency, and translation gains or losses in equity result from converting the functional currency balance sheet into the reporting currency. Dividing foreign currency exchange rate changes between transaction and translation can result in accounting results that decrease the comparability of financial statements and consolidated earnings.

The current hedge accounting model allows the parent company to hedge its net investment (a portfolio of assets and liabilities) and the functional currency subsidiary to hedge its earnings risk based on the individual assets and liabilities held in the functional currency entity. A net investment exposure is similar to a foreign earnings exposure, but under current accounting rules only the portfolio of net foreign equity (assets less liabilities) is eligible to benefit from the hedge accounting timing rules.

In summary, more meaningful consolidated accounting results can be attained by measuring foreign currency exposures from a single unit of measure; the reporting currency. Most large corporate treasury functions are no longer being managed on a separate, stand-alone basis. Investors and creditors are more interested in cash flows and net income in the reporting currency than in other currencies. And finally, portfolio hedge accounting rules for hedging foreign earnings and equity would not be necessary for multinational entities if the functional currency model were replaced by the use of a single unit of measure. I acknowledge this would be a difficult change to implement if it was mandatory. Therefore, an alternative approach would be to allow an election to use the reporting currency as the functional currency for all foreign currency operations.



Foreign currency provisions in ASC 830 Foreign Currency Matters (which replaced FAS 52), provide that an extensive interrelationship between the operations of the foreign entity and the parent company indicates that the parent company's currency should be the functional currency. It can be suggested that the growth and trend to move to central treasuries provides that extensive interrelationship for many multinational corporations. An election to convert to a single unit of measure could provide many multinational corporations the opportunity to achieve cash flow hedge accounting for these significant and material foreign currency exposures.

Sincerely,

A handwritten signature in black ink that reads "Robert Baer".

Robert Baer
Head of Derivative Accounting