FOREIGN EXCHANGE TRANSACTIONS

In this global world we live in, more and more of you are either selling to customers in non-domestic currencies or purchasing goods and services from foreign vendor and paying in their currency. To assist with facilitating these transactions, you often have non-domestic currency bank accounts.

Oneir Solutions Inc software allows you to make sales and carry out purchases is foreign non-domestic currencies…while accounting for the currency exchanges in the back ground. For example:

- **The sales order and invoicing option allows you to quote, take orders and invoice in domestic currency as well as one other currency. For most of our customers that is USD or CAD.**
- **The repetitive billing option also allows you to invoice in domestic currency as well as one other currency.**
- **The job cost manufacturing option allows you to make a quote and invoice a job in domestic currency as well as one other currency.**
- **The retail over-the-counter point of sale generally operated in domestic currency, however there is an option to provide pay in a non-domestic currency, with change provided in domestic funds.**
- **The purchasing option allows for a much broader flexibility whereby you can place orders from many global countries in their native currency with the receiving products and services being converted to your domestic currency.**

In all these cases you can charge the sales to your Accounts Receivable, charge the purchases to your Accounts Payable and use non-domestic bank accounts to receive payments and to pay bills. Oneir Solutions takes into consideration the impact on the General Ledger as well as providing an accurate reflecting of the profit margin on each and every sale. To assist with the decision regarding which currency to carry out commerce with the respective customers and suppliers, Oneir Solutions allows you to select a default currency for each.

In order to adjust for the value of your Accounts Receivable, Accounts Payables and their related Deposits, as well as reflecting the current balance of the foreign bank accounts in terms of the domestic values, Oneir Solutions suggests that you carry out month-end adjustments to the related Foreign Exchange accounts, often referred to as the FX Accounts. If monthly balancing is not carried out, you will certainly need to do this calculation during your year-end preparation.

About Exchange Rates

In the retail currency exchange market, a different buying rate and selling rate will be quoted by money dealers. Most trades are to or from the local domestic currency. The *buying rate* is the rate at which they will sell the currency and this rate is used when you consider the value of your foreign accounts payable, while the selling rate is the non domestic rate at which money dealers will sell you foreign currency. As such, this rate is used when you consider the value of your foreign bank accounts or your foreign accounts receivables.

The quoted rates will incorporate an allowance for a dealer's margin (or profit) in trading. The difference between the buy rate and the sell rate is the spread, and that is how money traders make money. Different rates may also be quoted for cash (usually notes only), a documentary form (such as traveler's checks) or electronically (such as a credit card purchase). The rates also vary with higher transaction values. The higher rate on documentary transactions has been justified to compensate for the additional time and cost of clearing the document, while the cash is available for resale immediately.

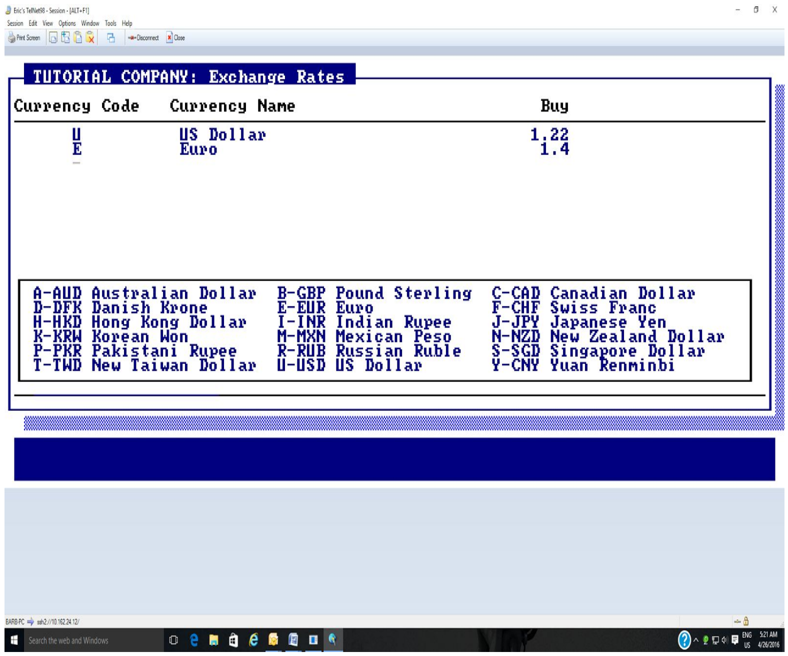
Exchange rates float freely against one another, which means they are in constant fluctuation. Currency valuations are determined by the flows of currency in and out of a country. A high demand for a particular currency usually means that the value of that currency will increase. However, the central bank in each country exerts controls over the currency to ensure the currencies don't fluctuate wildly. As a result, we suggest that you select a currency exchange rate for the month and "lock in" that rate at the beginning of the month. Only if there is a rapid revaluation of the currency during the month, should these rates be adjusted within Oneir Solutions.

Setting Up Exchange Rates

You can set the foreign exchange rates in Oneir Solutions in the Initialization selection under "3. Update exchange rates." This feature allows you to automatically convert between your domestic currency and one of the foreign currencies while you male sales and purchases.

Start by selecting the foreign currency exchange rate that you wish to use for making sales. In this case, the sale, taxes and extra charges will be multiplied by the currency exchange rate to give you a value for the transaction in domestic currency. For example, if you are a Canadian company that is selling to a US customer and the exchange rate is set at 1.2000, your $1000 sale will be reflected on your books as $1,200.

You can next set up the currencies and respective exchange rates that you will be purchasing in.



When you complete the revisions to your exchange rates for the upcoming period, you can print a report of the selected rates for your file.

Accounting for Sales and Purchases in Foreign Currencies

Below you will find examples for how you should be managing the currency exchanges so that profits are correctly reflected in each sale and costs are reflected when purchasing… and the company Income Statement and Balance Sheet is an accurate reflection of the company's current position.

MAKE A SALE TO A FOREIGN CUSTOMER

Let's make a $1,000 sale, for example, with a standard exchange rate of 1.38. The general ledger posting is as follows:

	Debit	Credit
Accounts Receivable	1000.00	
Currency Exchange	380.00	
Sales		1380.00
Cost of Goods Sold	600.00	
Inventory		600.00

Note that the sales are converted to domestic dollars. The conversion of the revenue to the domestic currency, with the difference between the foreign and domestic value

ensures proper accounting for the business as well as ensuring that the profit margin is reported correctly. It is assumed that the inventory and thus the cost of goods were converted into domestic currencies when they were first purchased…if they were purchased from a vendor in a foreign currency.

The profit margin calculation for the sale reflected in domestic funds is:

Sales	**1380.00**
Less **C of G**	**(600.00)**
Margin	**780.00**

When the A/R ledger is printed, it shows the individual invoice in the funds they were sold in, in this case USD funds. This method allows you to view the A/R and print Customer Statements in the correct funds. When the A/R is printed, a conversion value is shown on the A/R ledger to reflect the true value of the accounts receivable in domestic funds if the invoice(s) were paid today. The accounts receivable value for each customer is adjusted for the current exchange rate that you set up.

When the customer pays the outstanding invoice and the payment is deposited into the domestic bank account, the exchange rate will, most likely, be different. For this purpose, we will use an exchange rate of 1.3742.

	Debit	Credit
Bank (Domestic Funds)	1374.20	
Accounts Receivable		1000.00
Currency Exchange		374.20

You now have a variance of $5.80 in the Currency Exchange account resulting from this series of transactions.

	Debit	Credit
Currency Exchange--- Sale	380.00	
---Payment		374.20
Currency Exchange Variance		5.80

This variance will be posted to the Income Statement as a gain/(loss) on the currency exchange transactions at the end of the period. The procedure for calculating the gain/(loss) is shown later.

Of course, the payment could be deposited in your foreign funds bank account and the effect of the Gain/(Loss) on Currency Exchange will be delayed.

<u>MAKE A PURCHASE FROM A FOREIGN VENDOR</u>

Make a $2000.00 purchase from a foreign vendor for additional inventory. Use the standard exchange rate of 1.38.

	Debit	Credit
Inventory	2760.00	
Accounts Payable		2000.00
Currency Exchange		760.00

Note that the inventory is converted to domestic funds so that the inventory will be correctly and accurately valued. The individual product in inventory will be removed from inventory and expensed using the landed cost in domestic funds.

When the A/P ledger is printed, it shows the individual invoices in the funds they were purchased in: in this case in USD funds. This method allows you to view the A/P in the correct funds. When the A/P is printed, a conversion value is shown on the A/P ledger to reflect the value of the accounts payable in domestic funds. The accounts payable value for each vendor is adjusted for the latest current exchange rate that you set up.

When the invoice is paid and the check clears the bank, the exchange rate will, most likely, be different. For this purpose, we will use an exchange rate of 1.3710.

	Debit	Credit
Accounts Payable	2000.00	
Currency Exchange	742.00	
Bank (Canadian Dollars)		2742.00

You now have a variance of $18.00 in the Currency Exchange account resulting from this series of transactions.

	Debit	Credit
Currency Exchange---Purchase		760.00
---Payment	742.00	
Currency Exchange Variance		18.00

This variance will be posted to the income statement as a gain/(loss) on currency exchange transactions at the end of the period. The procedure for calculating the gain/(loss) is shown later.

CALCULATE GAIN/(LOSS) ON CURRENCY EXCHANGE TRANSACTIONS

There are three factors which are used to calculate the gain/(loss) on currency exchange transactions. These are the outstanding accounts receivables balance which are in foreign funds, the outstanding accounts payable balances which are in foreign funds and the balance in the non-domestic bank accounts.

Option 1: Using one FX General Ledger Account to record the exchange total balance.

At the end of the period, usually at the end of the month, adjust the currency exchange factor in the INITIALIZATION section of Vigilant to reflect the current exchange rate. Then print the accounts receivable ledger and the accounts payable ledger. At the end of the report, the conversion amount will be printed. We will use an exchange rate of 1.3812.

		Calculated Currency Exchange
	Accounts Receivable	**$3812.00**
	(Value of US A/R = $10,000 x .3812)	
plus	**Bank--US Funds**	**1143.60**
	(Balance in US funds = $3,000 x .3812)	
less	**Accounts Payable**	**(762.40)**
	(Value of US A/P = $2,000 x .3812)	
	Balance Currency Exchange Account	**4193.20 Dr**

Post a standard entry in the general ledger to adjust the Currency exchange account balance to equal the calculated value. If the balance in the computer is $4520.00 Dr, the posting should be (4520.00 Dr – 4193.20 Dr = 326.80 Dr):

	Debit	Credit
Gain/(Loss) Currency Transaction	**326.80**	
Currency Exchange – Gain/(Loss)		**326.80**

Option 1: Using an FX General Ledger Account to record the exchange total for each control account.

Note that many of our customers use a Foreign Exchange or FX general ledger account with each of their non-domestic bank account, their accounts receivable control account and their accounts payable control account. Using individual FX general ledger accounts often makes it easier to understand the impact of a currency fluctuation on each control account and their respective currencies. In this case, the difference between last period's FX account balance and the newly calculated balance for each FX General Ledger account can be posted to the respective FX Account with the offset entry posted to the Currency Gain/(Loss) account in the Income Statement. Use the selection "2. Post to general journal" in the General Ledger menu to post the entry.

END OF MONTH GENERAL LEDGER CONTROL ACCOUNT RECONCILIATIONS

At the end of the month, the Accounts Receivable, Accounts Payable and bank balance should be reconciled and compared to the General Ledger control accounts.

In order to verify the A/R and A/P, simply set the exchange rate to 1. Then print the A/R and A/P aged ledger. Compare the total value on the report with the value shown in the A/R and A/P General Ledger control accounts. In the case of the A/P, be sure that the Accounts Payable control account and the A/P deposits to vendors control account are combined before comparing with the A/P aged ledger. In a similar way, the Accounts Receivable control account and the A/R deposit from customers control account need to be combined before comparing with the A/R Aged ledger. If you are not sure which accounts in your General Ledger are be used for the Accounts Receivable and Accounts Payable general ledger default accounts, you can refer to the accounts that are set up for this purpose in the General Ledger selection "4. Set up special accounts." on pages 1 and 2.

Be sure not to forget to reset the currency exchange rate back to its correct amount in the INITIALIZATION section after you have printed the reports.

All bank account, both domestic and foreign currency accounts, should also be reconciled using the Bank Reconciliation procedures in the Oneir Solutions General Ledger.

END OF YEAR BALANCE SHEET CONSIDERATIONS

In preparation for your annual year-end audit, the balance sheet accounts which are shown in foreign funds must be converted to the domestic currency. In order to carry this out, the following reversing entry must be posted in the General Ledger. Using the previous example, conversion rate set at .3812.

(Reversing Entry)	Debit	Credit
Accounts Receivable	3812.00	
(Value of US A/R = $10,000 x .3812)		
Bank--US Funds	1143.60	
(Balance in US Funds = $3,000 x .3812)		
Accounts Payable		762.40
(Value of US A/P = $2,000 x .3812)		
Currency Exchange (For each FX Account)		4193.20

This will leave the end of the period balance in the Currency Exchange Balance Sheet account at zero.-

YEAR-END ADJUSTING ENTRIES

Note that your external accountant may provide revaluations for the foreign bank accounts, the accounts receivable and the accounts payable control accounts as a result of the audit process to reflect the balance sheet values in domestic funds. If this is the case, use the General Ledger "Reversing Entry" for the posting at year-end.

However, using the routine procedures for posting FX Account values that is discussed in this procedure manual will ensure that you are on top of your businesses currency exchange impacts and that the need for your auditor making these calculations, and the associated costs and year-end adjusting entries, will not be required.