Statutory Issue Paper No. 81

Foreign Currency Transactions and Translations

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Common Area

SUMMARY OF ISSUE

1. A foreign currency transaction is a transaction denominated in a currency other than the reporting entity's functional currency. The reporting entity's functional currency is defined as the currency of the primary economic environment in which the reporting entity operates. Foreign currency translation is the translation of financial statements, denominated in the reporting entity's functional currency, into U.S. dollars prior to their incorporation into financial statements through consolidation or the equity method of accounting.

2. Current statutory guidance for accounting for foreign currency transactions is provided in Chapters 13 and 25 of the Accounting Practices a

numerous revenues, expenses, gains, and losses are recognized is generally impractical, an appropriately weighted average exchange rate for the period may be used to translate those elements.

6. The purpose of this issue paper is to establish statutory accounting principles for accounting for foreign currency transactions and translation that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

7. For the purposes of this issue paper, a U.S. domiciled entity's reporting cu

10. All other foreign currency transactions shall be accounted for as follows:

    a. Assets and liabilities denominated in foreign currencies shall be accounted for at their U.S. dollar equivalent values using exchange rates at the balance sheet date. Income and expenses recognized during an accounting period shall be recorded at an appropriately weighted average exchange rate.

    b. Changes in balance sheet asset and liability values due to fluctuations in foreign currency

Drafting Notes/Comments

- Forward exchange contracts are addressed in a separate issue paper.

RELEVANT STATUTORY AND GAAP GUIDANCE

Statutory Accounting

17. The P&C Accounting Practices and Procedures Manual, Chapter 13, Other Liabilities, provides the following guidance:

> Net Adjustments in Assets and Liabilities Due to Foreign Exchange Rates
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> An insurance company may have assets or liabilities payable in foreign currencies.
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> Differences between the exchange rates when the original entries were recorded and the current statement date result in changes in net asset value. Reductions in net asset value are shown under this caption, while increases are recorded as an asset under aggregate write-ins for other-than-invested assets. If different foreign currencies are involved, the assets and liabilities must be segregated accordingly and applied against the proper exchange rate. The exchange rates to be used are those published in the NAIC manual.

18. The P&C Accounting Practices and Procedures Manual, Chapter 25, Unassigned Funds (Surplus) provides the following guidance with respect to foreign exchange adjustments:

> Change in Foreign Exchange Adjustment
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> Assets and liabilities in foreign currency are subject to adjustment to the prevailing foreign exchange rate. The change in the foreign exchange adjustment between the current and prior statement is charged or credited directly to unassigned surplus. (See Chapter 13-Other Liabilities.)

19. The Life/A&H Accounting Practices and Procedures Manual, Chapter 8, Other Admitted Assets, provides the following guidance:

> Foreign Exchange Adjustment
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> Some insurers engage in operations in foreign countries, with the premiums collected and claims paid in the local currency. As in any insurance operations there will at all times be uncollected premiums, policy reserves, unpaid claims, and other incomplete transactions that must be recorded in the insurer's balance sheet in the annual statement.
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> For ease in maintaining policy records, the premiums, reserves and claims normally are recorded in U.S. dollars at the rate of exchange that is in effect at the time the policy is written, or when the company receives notification of the claim. Changes in exchange rates, while not affecting the foreign policyholder, do affect the value of the foreign business as it is recorded in U.S. dollars. Because of the constant fluctuations in the foreign currencies' exchange rates, it may be confusing and unduly burdensome to adjust individual policy and claims records to current rates. Most companies, therefore, make such adjustment to the net balance of the assets and liabilities in each foreign currency.
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> The adjustment is calculated by summarizing the assets and liabilities in each foreign currency and in U.S. dollars, as recorded in the company's policy and claim records. The net value in the foreign currency is converted to U.S. dollars at the current rate of exchange and compared with the net value in U.S. dollars recorded by the company. Any difference in adjustment of the net value to current exchange rates is recorded as a separate asset or liability if the current rate is greater or less than the rate used by the company.
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> Change in foreign exchange adjustments generally are reported as capital gain or loss.

20. The SVO Purposes and Procedures Manual, Section 1, provides the following guidance:

Market values for securities payable in other than U.S. dollars will be computed by obtaining a

13. If an entity's functional currency is a foreign currency, translation adjustments result from the process of translating that entity's financial statements into the reporting currency. Translation adjustments shall not be included in determining net income but shall be reported separately and accumulated in a separate component of equity.

14. Upon sale or upon complete or substantially complete liquidation of an investment in a foreign entity, the amount attributable to that entity and accumulated in the translation adjustment component of equity shall be removed from the separate component of equity and shall be reported as part of the gain or loss on sale or liquidation of the investment for the period during which the sale or liquidation occurs.

Foreign Currency Transactions

15. Foreign currency transactions are transactions denominated in a currency other than the entity's functional currency. Foreign currency transactions may produce receivables or payables that are fixed in terms of the amount of foreign currency that will be received or paid. A change in exchange rates between the functional currency and the currency in which a transaction is denominated increases or decreases the expected amount of functional currency cash flows upon settlement of the transaction. That increase or decrease in expected functional currency cash flows is a foreign currency transaction gain or loss that generally shall be included in determining net income for the period in which the exchange rate changes. Likewise, a transaction gain or loss (measured from the transaction date or the most recent intervening balance sheet date, whichever is later) realized upon settlement of a foreign currency transaction generally shall be included in determining net income for the period in which the transaction is settled. The exceptions to this requirement for inclusion into this requinsactio0ction gain sand

Use of Averages or Other Methods of Approximation

29. Literal application of the standards in this Statement might require a degree of detail in record keeping and computations that could be burdensome as well as unnecessary to produce reasonable approximations of the results. Accordingly, it is acceptable to use averages or other methods of approximation. For example, the propriety of using average rates to translate revenue and expense amounts is noted in paragraph 12. Likewise, the use of other time-and effort-saving methods to approximate the results of detailed calculations is permitted.

Disclosure

30. The aggregate transaction gain or loss included in determining net income for the period shall be disclosed in the financial statements or notes thereto. For that disclosure, gains and losses on forward contracts determined in conformity with the requirements of paragraphs 18 and 19 shall be considered transaction gains or losses. Certain enterprises, primarily banks, are dealers in foreign exchange. Although certain gains or losses from dealer transactions may fit the definition of transaction gains or losses in this Statement, they may be disclosed as dealer gains

U.S. dollar equivalent values. Income recognized during an accounting period should be recorded at its weighted average U.S. dollar equivalent value, and balance sheet data should be recorded at its U.S. dollar equivalent value as of the balance sheet date.

Changes in balance sheet investment value due to foreign currency translation should be recorded as unrealized capital gains and losses on such investment until the investment is repaid or sold. Upon sale or repayment previously recorded unrealized capital gains and losses should be reversed and the foreign exchange profit or loss for the entire holding period should be recorded as a realized capital gain or loss.

Transactions involving settlement in cash, such as purchases, sales, and receipt of income, should be recorded at their U.S. dollar equivalent value based on the foreign currency exchange rate as of the transaction date. Any foreign currency exchange gains or losses on purchases, sales, maturities or changes in income accruals should be recorded as capital gain or loss realized on the purchase, sale or maturity or as adjustments to income respectively.

Nominal information such as par value may be expressed in the foreign currency or U.S. dollar equivalent (description of issue), but where the information is displayed comparatively (column of par values), U.S. dollar equivalent amount should be used. Ratios and factors should be based on data that is entirely consistent with respect to currency.

Attachment B

ACCOUNTING FOR INVESTMENTS DENOMINATED IN FOREIGN CURRENCY HELD IN SUPPORT OF INSURANCE BUSINESS DENOMINATED IN THE SAME FOREIGN CURRENCY

Some insurers engage in operations in foreign countries with the premiums collected and claims paid in local currency. As in any insurance operation there will at times be uncollected premiums policy reserves, unpaid claims, and other incomplete transactions that must be recorded in the insurer's balance sheet in the annual statement. For ease in maintaining policy records, the premiums reserves, and claims normally are recorded in U.S. dollars at the rate of exchange that is in effect at the time the policy is written, or when the company receives notification of the claim. Changes in exchange rates, while not affecting the foreign policyholder, do affect the value of the foreign business as it is recorded in U.S. dollars.

Canadian operations, comprising less than 10% of the insurance company’s assets or liabilities can be translated to U.S. dollars by making an adjustment to the net assets of the foreign operation. The adjustment is calculated by summarizing the assets and liabilities in the foreign currency and in U.S. dollars. The net value is converted to U.S. dollars at the current rate of exchange and compared with the net value in U.S. dollars recorded by the company. Any difference in the net value to current exchange rates is recorded as a separate asset or liability and the change in the foreign exchange adjustment is recorded as an unrealized capital gain or loss.

All other foreign operations must be translated to U.S. dollars in accordance with the provisions of Financial Accounting Standards Board Statement of Financial Accounting Standard (FAS) No. 52, Foreign Currency Translation. FAS 52 requires each financial statement line to be translated to U.S. dollars by applying the following exchange rates: l) the current exchange rate at the balance sheet date to assets and liabilities and 2) a weighted average rate to revenue, expenses, gains, losses and surplus adjustments. The weighted-average rate is aimed at approximating the translation that would have been achieved had the current rate at the time of each translation been applied. Gains or losses due to translating foreign operations to U.S. dollars should be recorded as an unrealized capital gain or loss.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapters 13 and 25
- Accounting Practices and Procedures Manual for Life, Accident and Health Insurance Companies, Chapter 8
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