

Statutory Issue Paper No. 81

Foreign Currency Transactions and Translations

STATUS

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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 and Procedures Manual for Property and Casualty Insurance Companies (P&C Accounting Practices and Procedures Manual) and Chapter 8 of the Accounting Practices and Procedures Manual for Life, Accident, and Health Insurance Companies (Life/A&H Accounting Practices and Procedures Manual). This guidance requires foreign currency transactions to be recorded in U.S. dollars at the exchange rate in effect at the time of the transaction. At each subsequent statement date, all net assets recorded in each foreign currency are converted to U.S. dollars at the exchange rate in effect at the statement date. Property and casualty insurers record a change in net assets due to changes in foreign exchange rates between the original transaction date and the current statement date as an additional and separate asset or liability with a corresponding adjustment made directly to surplus. Life and accident and health insurers record an additional and separate asset or liability with a corresponding entry to capital gain or loss.
3. Limited statutory guidance for accounting for foreign currency transactions is also provided in the *Purposes and Procedures Manual of the NAIC Securities Valuation Office (SVO Purposes and Procedures)*. This guidance requires that market values for securities payable in other than U.S. dollars to be computed by obtaining a quotation in the foreign currency from a reputable source and converting that quotation into U.S. dollars using the exchange rates published in the Valuation of Securities Manual.
4. GAAP guidance for accounting for foreign currency transactions is provided in *FASB Statement No. 52, Foreign Currency Translation* (FAS 52). This guidance requires each asset, liability, revenue, expense, gain, or loss arising from a transaction to be measured and recorded in the functional currency of the recording entity by use of the exchange rate in effect at that date. Subsequently, at each balance sheet date, assets and liabilities that are denominated in a currency other than the functional currency of the recording entity are adjusted to reflect the current exchange rate. Any changes in the assets or liabilities from the date of the original transaction to the balance sheet date resulting from exchange rate fluctuations, are included in net income for the period in which the change occurred.
5. GAAP guidance for accounting for foreign currency translation is also provided in FAS 52. This guidance requires all assets and liabilities to be translated at the exchange rate at the balance sheet date, while revenues, expenses, gains, and losses are translated at the exchange rate in effect at the dates on which the transactions were recognized. Because translation at the exchange rates at the dates the

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 currency shall be defined as the U.S. dollar, regardless of the primary economic environment in which the reporting entity operates. In order to ensure consistency, all elements of statutory financial statements shall be reported in U.S. dollars.

8. Each foreign currency transaction shall be examined and a determination made if the foreign currency transaction was made in support of insurance operations denominated in the same foreign currency. For example, some reporting entities 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 reporting entity's balance sheet. 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 claim is incurred. 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.

9. Foreign currency transactions made in support of insurance operations denominated in the same foreign currency, such as foreign branches, shall be accounted for as follows:

a. Canadian Insurance Operations

Canadian insurance operations, resulting in less than 10% of the reporting entity's admitted assets, less than 10% of the reporting entity's liabilities and less than 10% of the reporting entity's net premium, 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 reporting entity. 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.

b. All Other Foreign Insurance Operations

All other foreign insurance operations must be translated to U.S. dollars as follows: each financial statement line shall be translated to U.S. dollars by applying the following exchange rates: 1) for assets and liabilities, the exchange rate at the balance sheet date shall be used and 2) for revenues, expenses, gains, losses and surplus adjustments, the exchange rate at the dates on which those elements are recognized shall be used. Because translation at the exchange rates at the dates the numerous revenues, expenses, gains, losses and surplus adjustments are recognized is generally impractical, an appropriately weighted average exchange rate for the period may be used to translate those elements. Gains or losses due to translating foreign operations to U.S. dollars shall be recorded as an unrealized capital gain or loss.

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 exchange rates shall be recorded as unrealized capital gains and losses until the asset is sold or exchanged or the liability is settled. Upon settlement, previously recorded unrealized capital gains and losses shall be reversed and the foreign exchange profit or loss for the entire holding period shall be recorded as a realized capital gain or loss.
 - c. Transactions involving settlement in cash, such as purchases, payment of expenses, sales, and receipt of income, shall 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, payment of expenses, sales, maturities or changes in income or expense accruals should be recorded as capital gain or loss realized on the purchase, sale or maturity.
11. Nominal information such as par value of investments 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. The U.S. dollar equivalent amount is translated utilizing the exchange rate at the balance sheet date. Ratios and factors should be based on data that is entirely consistent with respect to currency.
12. A currency in a highly inflationary environment (one that has cumulative inflation of approximately 100% or more over a three year period) is not considered stable enough to serve as a functional currency and the more stable currency of the reporting parent is to be used instead. If a reporting entity's books of record are not maintained in its functional currency, remeasurement into the functional currency is required. That remeasurement is required before translation into the reporting currency. The remeasurement process is intended to produce the same result as if the reporting entity's books of record had been maintained in the functional currency. The remeasurement of and subsequent accounting for transactions denominated in a currency other than the functional currency shall be in recognized as a realized gain or loss in the statement of operations.

DISCUSSION

13. This issue paper rejects current statutory accounting principles. Current statutory guidance for property and casualty insurers provides that fluctuations in the value of assets and liabilities be summarized and recorded as a net asset or liability with an offsetting adjustment made directly to surplus. Current statutory guidance for life and accident and health insurers provides that fluctuations in the values of assets and liabilities be summarized and recorded as a net asset or liability with a corresponding entry recorded as a capital gain or loss. The conclusions reached in this issue paper require all assets and liabilities to be translated at the exchange rate in effect at the balance sheet date with the corresponding entry recorded as an unrealized gain or loss (see paragraph 14 for reference to exemption for certain Canadian branch operations). This change to require life and accident and health insurers to reflect the translation gain or loss as unrealized was made to conform accounting treatment for the translation adjustment between property and casualty insurers and life and health insurers. Requiring all assets and liabilities to be translated at the exchange rate in effect at the balance sheet date provides more meaningful information to regulators and other financial statement users. The statutory principles outlined in the conclusion above are consistent with draft statutory guidance prepared by the Invested Assets Working Group of the Valuation of Securities (EX4) Task Force.

14. Subparagraph 9.a. of this issue paper affords different treatment to certain Canadian branch operations. As a matter of historic practice, U.S. reporting entities have treated Canadian branch operations in their statutory statements as if they were U.S. dollar denominated operations. This practice was established at a time when the Canadian and U.S. dollars were at or close to equivalent. The cost of translating each line item for immaterial Canadian operations is perceived to exceed the benefits of line-by-line exactness. Consideration has also been given to the impact on risk-based capital and the asset valuation reserve of reporting entities under the provisions of subparagraph 9 a. and the impact is not considered to be material.

15. The statutory principles outlined in the conclusion above are not consistent with current GAAP as follows:

- a. Subparagraph 9.a. Allows changes in balance sheet asset and liability values due to exchange rate fluctuations of a reporting entity's Canadian insurance operations comprising less than 10% of the reporting entity's admitted assets and liabilities and net premium to be recorded as unrealized capital gains or losses with a corresponding adjustment made to a net asset or liability. GAAP requires each asset and liability account to be adjusted.
- b. Paragraph 10 allows changes in balance sheet asset and liability values due to exchange rate fluctuations to be recorded as unrealized capital gains or losses. GAAP requires that fluctuations in asset values that arose as a result of transactions denominated in a foreign currency be recorded as part of net income. GAAP requires that a gain or loss resulting from translating the financial statements of an operation that has a functional currency other than the U.S. dollar be recorded as unrealized. Recording gains and losses as a result of fluctuations in exchange rates as unrealized gains and losses for statutory purposes affords these fluctuations the same accounting treatment as fluctuations in the market values of equity securities.

This issue paper rejects FAS 52, *Foreign Currency Translation*, FASB Emerging Issues Task Force No. 87-12, *Foreign Debt-for-Equity Swaps*, FASB Emerging Issues Task Force No. 87-26, *Hedging of Foreign Currency Exposure with a Tandem Currency*, FASB Emerging Issues Task Force No. 92-4, *Accounting for a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary*, FASB Emerging Issues Task Force No. 95-2, *Determination of What Constitutes a Firm Commitment for Foreign Currency Transactions Not Involving a Third Party*, FASB Emerging Issues Task Force No. 96-15, *Accounting for the Effects of Changes in Foreign Currency Exchange Rates on Foreign-Currency-Denominated Available-for-Sale Debt Securities and FASB Interpretation No. 37*, *Accounting for Translation Adjustments upon Sale of Part of an Investment in a Foreign Entity*, an interpretation of FASB Statement No. 52, and *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins*, Chapter 12.

16. The statutory principles outlined in the conclusion above are consistent with the recognition and consistency concepts in the Statement of Concepts. Pertinent excerpts follow:

Consistency

The regulators' need for meaningful, comparable financial information to determine an insurer's financial condition requires consistency in the development and application of statutory accounting principles.

Recognition

The principal focus of solvency measurement is determination of financial condition through analysis of the balance sheet. However, protection of the policyholders can only be maintained through continued monitoring of the financial condition of the insurance enterprise.

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

An insurance company may have assets or liabilities payable in foreign currencies.

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 *Valuation of Securities* 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

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

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.

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.

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.

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 quotation in the foreign currency from a reputable source and converting that quotation into U.S. dollars using the exchange rates published in the VOS Manual.

Generally Accepted Accounting Principles

21. FAS 52 provides the following guidance:

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Objectives of Translation

4. Financial statements are intended to present information in financial terms about the performance, financial position, and cash flows of an enterprise. For this purpose, the financial statements of separate entities within an enterprise, which may exist and operate in different economic and currency environments, are consolidated and presented as though they were the financial statements of a single enterprise. Because it is not possible to combine, add, or subtract measurements expressed in different currencies, it is necessary to translate into a single reporting currency² those assets, liabilities, revenues, expenses, gains, and losses that are measured or denominated in a foreign currency³. However, the unity presented by such translation does not alter the underlying significance of the results and relationships of the constituent parts of the enterprise. It is only through the effective operation of its constituent parts that the enterprise as a whole is able to achieve its purpose. Accordingly, the translation of the financial statements of each component entity of an enterprise should accomplish the following objectives:

- a. Provide information that is generally compatible with the expected economic effects of a rate change on an enterprise's cash flows and equity
- b. Reflect in consolidated statements the financial results and relationships of the individual consolidated entities as measured in their functional currencies in conformity with U.S. generally accepted accounting principles

² For convenience, this Statement assumes that the enterprise uses the U.S. dollar (dollar) as its reporting currency. However, a currency other than the dollar may be the reporting currency in financial statements that are prepared in conformity with U.S. generally accepted accounting principles. For example, a foreign enterprise may report in its local currency in conformity with U.S. generally accepted accounting principles. If so, the requirements of this Statement apply.

³ To measure in foreign currency is to quantify an attribute of an item in a unit of currency other than the reporting currency. Assets and liabilities are denominated in a foreign currency if their amounts are fixed in terms of that foreign currency regardless of the exchange rate changes. An asset or liability may be both measured and denominated in one currency, or it may be measured in one currency and denominated in another. To illustrate: Two foreign branches of a U.S. Company, one Swiss and one German, purchase identical assets on credit from a Swiss vendor at identical prices stated in Swiss francs. The German branch measures the cost (an attribute) of that asset in German marks. Although the corresponding liability is also measured in marks, it remains denominated in Swiss francs since the liability must be settled in a specific number of Swiss francs. The Swiss branch measures the asset and liability in Swiss francs. Its liability is both measured and denominated in Swiss francs. Although assets and liabilities can be measured in various currencies, rights to receive or obligations to pay fixed amounts of a currency are, by definition, denominated in that currency.

The Functional Currency

5. The assets, liabilities, and operations of a foreign entity shall be measured using the functional currency of that entity. An entity's functional currency is the currency of the primary economic environment in which the entity operates; normally, that is the currency of the environment in which an entity primarily generates and expends cash. Appendix A provides guidance for determination of the functional currency. The economic factors cited in Appendix A,

and possibly others, should be considered both individually and collectively when determining the functional currency.

6. For an entity with operations that are relatively self-contained and integrated within a particular country, the functional currency generally would be the currency of that country. However, a foreign entity's functional currency might not be the currency of the country in which the entity is located. For example, the parent's currency generally would be the functional currency for foreign operations that are a direct and integral component or extension of the parent company's operations.

7. An entity might have more than one distinct and separable operation, such as a division or branch, in which case each operation may be considered a separate entity. If those operations are conducted in different economic environments, they might have different functional currencies.

8. The functional currency (or currencies) of an entity is basically a matter of fact, but in some instances the observable facts will not clearly identify a single functional currency. For example, if a foreign entity conducts significant amounts of business in two or more currencies, the functional currency might not be clearly identifiable. In those instances, the economic facts and circumstances pertaining to a particular foreign operation shall be assessed in relation to the Board's stated objectives for foreign currency translation (paragraph 4). Management's judgment will be required to determine the functional currency in which financial results and relationships are measured with the greatest degree of relevance and reliability.

9. Once the functional currency for a foreign entity is determined, that determination shall be used consistently unless significant changes in economic facts and circumstances indicate clearly that the functional currency has changed. Previously issued financial statements shall not be restated for any change in the functional currency.

10. If an entity's books of record are not maintained in its functional currency, remeasurement into the functional currency is required. That remeasurement is required before translation into the reporting currency. If a foreign entity's functional currency is the reporting currency, remeasurement into the reporting currency obviates translation. The remeasurement process is intended to produce the same result as if the entity's books of record had been maintained in the functional currency. The remeasurement of and subsequent accounting for transactions denominated in a currency other than the functional currency shall be in accordance with the requirements of this Statement (paragraphs 15 and 16). Appendix B provides guidance for remeasurement into the functional currency.

The Functional Currency in Highly Inflationary Economies

11. The financial statements of a foreign entity in a highly inflationary economy shall be remeasured as if the functional currency were the reporting currency. Accordingly, the financial statements of those entities shall be remeasured into the reporting currency according to the requirements of paragraph 10. For the purposes of this requirement, a highly inflationary economy is one that has cumulative inflation of approximately 100 percent or more over a 3-year period.

Translation of Foreign Currency Statements

12. All elements of financial statements shall be translated by using a current exchange rate. For assets and liabilities, the exchange rate at the balance sheet date shall be used. For revenues, expenses, gains, and losses, the exchange rate at the dates on which those elements are recognized shall be used. Because translation at the exchange rates at the dates the 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.

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 in net income of transaction gains and losses are set forth in paragraphs 20 and 21 and pertain to certain intercompany transactions and to transactions that are designated as, and effective as, economic hedges of net investments and foreign currency commitments.

16. For other than forward exchange contracts (paragraphs 17-19), the following shall apply to all foreign currency transactions of an enterprise and its investees:

- a. At the date the transaction is recognized, each asset, liability, revenue, expense, gain, or loss arising from the transaction shall be measured and recorded in the functional currency of the recording entity by use of the exchange rate in effect at that date (paragraphs 26-28).
- b. At each balance sheet date, recorded balances that are denominated in a currency other than the functional currency of the recording entity shall be adjusted to reflect the current exchange rate.

Transaction Gains and Losses to Be Excluded from Determination of Net Income

20. Gains and losses on the following foreign currency transactions shall not be included in determining net income but shall be reported in the same manner as translation adjustments (paragraph 13):

- a. Foreign currency transactions that are designated as, and are effective as, economic hedges of a net investment in a foreign entity, commencing as of the designation date
- b. Intercompany foreign currency transactions that are of a long-term-investment nature (that is, settlement is not planned or anticipated in the foreseeable future), when the entities to the transaction are consolidated, combined, or accounted for by the equity method in the reporting enterprise's financial statements

21. A gain or loss on a forward contract or other foreign currency transaction that is intended to hedge an identifiable foreign currency commitment (for example, an agreement to purchase or sell equipment) shall be deferred and included in the measurement of the related foreign currency transaction (for example, the purchase or the sale of the equipment). Losses shall not

be deferred, however, if it is estimated that deferral would lead to recognizing losses in later periods. A foreign currency transaction shall be considered a hedge of an identifiable foreign currency commitment provided both of the following conditions are met:

- a. The foreign currency transaction is designated as, and is effective as, a hedge of a foreign currency commitment.
- b. The foreign currency commitment is firm.

The required accounting shall commence as of the designation date. The portion of a hedging transaction that shall be accounted for pursuant to this paragraph is limited to the amount of the related commitment. If a hedging transaction that meets conditions (a) and (b) above exceeds the amount of the related commitment, the gain or loss pertaining to the portion of the hedging transaction in excess of the commitment shall be deferred to the extent that the transaction is intended to provide a hedge on an after-tax basis. A gain or loss so deferred shall be included as an offset to the related tax effects in the period in which such tax effects are recognized; consequently, it shall not be included in the aggregate transaction gain or loss disclosure required by paragraph 30. A gain or loss pertaining to the portion of a hedging transaction in excess of the amount that provides a hedge on an after-tax basis shall not be deferred. Likewise, a gain or loss pertaining to a period after the transaction date of the related commitment shall not be deferred. If a foreign currency transaction previously considered a hedge of a foreign currency commitment is terminated before the transaction date of the related commitment, any deferred gain or loss shall continue to be deferred and accounted for in accordance with the requirements of this paragraph.

Exchange Rates

26. The exchange rate is the ratio between a unit of one currency and the amount of another currency for which that unit can be exchanged at a particular time. If exchangeability between two currencies is temporarily lacking at the transaction date or balance sheet date, the first subsequent rate at which exchanges could be made shall be used for purposes of this Statement. If the lack of exchangeability is other than temporary, the propriety of consolidating, combining, or accounting for the foreign operation by the equity method in the financial statements of the enterprise shall be carefully considered (ARB 43, Chapter 12, paragraph 8).

27. The exchange rates to be used for translation of foreign currency transactions and foreign currency statements are as follows:

- a. Foreign Currency Transactions - The applicable rate at which a particular transaction could be settled at the transaction date shall be used to translate and record the transaction. At a subsequent balance sheet date, the current rate is that rate at which the related receivable or payable could be settled at that date.
- b. Foreign Currency Statements - In the absence of unusual circumstances, the rate applicable to conversion of a currency for purposes of dividend remittances shall be used to translate foreign currency statements.⁴

⁴ If unsettled intercompany transactions are subject to and translated using preference or penalty rates, translation of foreign currency statements at the rate applicable to dividend remittances may cause a difference between intercompany receivables and payables. Until that difference is eliminated by settlement of the intercompany transaction, the difference shall be treated as a receivable or payable in the enterprise's financial statements.

28. If a foreign entity whose balance sheet date differs from that of the enterprise is consolidated or combined with or accounted for by the equity method in the financial statements of the enterprise, the current rate is the rate in effect at the foreign entity's balance sheet date for purposes of applying the requirements of this Statement to that foreign entity.

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 or losses rather than as transaction gains or losses.

31. An analysis of the changes during the period in the separate component of equity for cumulative translation adjustments shall be provided in a separate financial statement, in notes to the financial statements, or as part of a statement of changes in equity. At a minimum, the analysis shall disclose:

- a. Beginning and ending amount of cumulative translation adjustments
- b. The aggregate adjustment for the period resulting from translation adjustments (paragraph 13) and gains and losses from certain hedges and intercompany balances (paragraph 20)
- c. The amount of income taxes for the period allocated to translation adjustments (paragraph 24)
- d. The amounts transferred from cumulative translation adjustments and included in determining net income for the period as a result of the sale or complete or substantially complete liquidation of an investment in a foreign entity (paragraph 14)

32. An enterprise's financial statements shall not be adjusted for a rate change that occurs after the date of the enterprise's financial statements or after the date of the foreign currency statements of a foreign entity if they are consolidated, combined, or accounted for by the equity method in the financial statements of the enterprise. However, disclosure of the rate change and its effects on unsettled balances pertaining to foreign currency transactions, if significant, may be necessary.

OTHER SOURCES OF INFORMATION

22. The Invested Assets Working Group of the Valuation of Securities (EX4) Task Force presented the following draft guidance to the Blanks Task Force:

Attachment A

**NAIC ACCOUNTING PRINCIPLES
ACCOUNTING FOR INVESTMENTS DENOMINATED
IN FOREIGN CURRENCY
OTHER THAN INVESTMENTS HELD IN SUPPORT OF
INSURANCE BUSINESS DENOMINATED IN THE SAME FOREIGN
CURRENCY**

Investments denominated in foreign currencies other than investments held in support of insurance business denominated in the same foreign currency, should be accounted for at their

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: 1) 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.

Source for language of Attachment B: Foreign Exchange Adjustment. Chapter 8, Phase II of Life and Health Accounting Manual Codification Project

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
- *Purposes and Procedures Manual of the NAIC Securities Valuation Office*, Section 1

Generally Accepted Accounting Principles

- *FASB Statement No. 52, Foreign Currency Translation*
- *FASB Emerging Issues Task Force No. 87-12, Foreign Debt-for-Equity Swaps*
- *FASB Emerging Issues Task Force No. 87-26, Hedging of Foreign Currency Exposure with a Tandem Currency*
- *FASB Emerging Issues Task Force No. 92-4, Accounting for a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary*
- *FASB Emerging Issues Task Force No. 95-2, Determination of What Constitutes a Firm Commitment for Foreign Currency Transactions Not Involving a Third Party*
- *FASB Emerging Issues Task Force No. 96-15, Accounting for the Effects of Changes in Foreign Currency Exchange Rates on Foreign-Currency-Denominated Available-for-Sale Debt Securities*
- *FASB Interpretation No. 37, Accounting for Translation Adjustments upon Sale of Part of an Investment in a Foreign Entity, an interpretation of FASB Statement No. 52*
- *Accounting Research Bulletin No. 43, Restatement and Revision of Accounting Research Bulletins, Chapter 12*

State Regulations

None

Other Sources of Information

- The Invested Assets Working Group of the Valuation of Securities (EX4) Task Force draft guidance to the Blanks Task Force
- NAIC Technical Resource Group Proposed Draft Life Codification, Chapter 8