



Foreign Currency Transactions and Translation of Statements Under U.S. GAAP

In recent years, there has been growing interest in foreign investments made by U.S. companies. These investments are typically held directly by the reporting entity, through a subsidiary or through a joint venture. A reporting entity conducting transactions in more than one currency is required to measure and recognize the changes in different units of currency in relationship to its reporting currency.

The Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 830 “Foreign Currency Matters” provides guidance on foreign currency transactions and translation of financial statements.¹ There are several key concepts and definitions that reporting entities must understand and consider when applying ASC 830. Below is a selected list of the initial steps to be considered by companies investing in foreign assets:

- **Determining the entity’s reporting currency** – The reporting currency is the currency in which a reporting entity prepares its financial statements.
- **Identifying and accounting for a foreign entity** – Companies must determine if they have an investment in a foreign entity or separable operations that may be considered separate foreign entities. Potentially a subsidiary may have self-contained and integrated operations in different countries and, as a result, each operation may be considered an entity with a different functional currency. A foreign entity is an operation whose

other than the reporting currency of the reporting entity and (b) combined or consolidated with or accounted for on the equity basis in the financial statements of the reporting entity. Foreign entity statements must be translated into the reporting currency.

- **Determining the functional currency** – The functional currency for each entity in the reporting entity’s structure must be determined and may require significant judgement. 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. Although the functional currency may appear to be a matter of fact, there are instances in which a foreign entity conducts its business in two or more foreign currencies and the determination of the functional currency may require significant judgement to provide the greatest degree of relevance and reliability to the company’s financial results.

- **Accounting for foreign currency transactions** – Transactions denominated in other than the entity’s functional currency need to be measured in the functional currency of the reporting entity by use of the exchange rates, both initially and in subsequent periods. The change in the exchange rates between the functional currency and the currency in which the transaction is denominated results in transaction gains or losses that are generally included in determining net income for the period.
- **Translating foreign currency statements** – Foreign currency statements that are incorporated in the financial statements of the reporting entity by consolidation, combination, or the equity method of accounting must be translated into the reporting currency by use of the exchange rates. Translation adjustments resulting from this process should not be included in determining net income but rather should be reported in other comprehensive income.
- **Determining the exchange rates to be applied** – ASC 830 provides guidance on the use of historical rates, average rates, and spot rates, based on the accounts or transactions being measured or translated. 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.

An understanding of these steps and a disciplined approach to analyzing investments in foreign assets is crucial in arriving at the proper accounting treatment in accordance with U.S. GAAP.

The application of the guidance in ASC 830, especially in today’s global economy, can be challenging, and it may require extensive consideration and judgement. FTI Consulting can provide these accounting and consulting services.

Endnotes

¹ FASB ASC 830 Foreign Currency Matters, <https://asc.fasb.org/1943274/2147481988>.

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