

Mohammed Amin's Finance and Treasury blog

Should companies hedge against translation risk?

[My last posting](#) looked at the tax rules that apply when a company hedges translation risk. As promised then, I am writing to discuss whether companies should hedge translation risk at all.

This posting is adapted from my article in the October 2005 edition of Financial Instruments Tax and Accounting Review.

My experience of working with large corporates on treasury matters has found three distinct approaches to dealing with translation risk:

1. Companies which consistently hedge against 100% of the translation risk that they face.
2. Companies that never hedge against translation risk as a matter of policy.
3. Companies that hedge part of their translation risk.

In the case of partial hedging, sometimes the hedging proportion is set to ensure liabilities are the same proportion of assets for all of the currencies the company deals in. At other times it just seems to depend on the judgement of the treasurer.

Some time ago, I asked myself whether there was a theoretically correct answer regarding the approach that should be taken to translation risk. A search of the literature found a large number of articles on the subject, many quite old. The scarcity of recent articles perhaps indicates that the issue is now regarded as familiar and no longer worthy of additional research. The articles tended to either simply explain translation risk or to be surveys of the actual practice of corporates regarding whether or not to hedge. However, I could not find anything addressing the issue on theoretical grounds.

In this posting, I have tackled the issue from first principles.

1 What is translation risk?

For a UK group, translation risk arises from the fact that for each accounting period, one needs to translate the foreign currency financial statements of its foreign subsidiaries into sterling in order to prepare the consolidated accounts of the group (assumed to be in sterling). This translation can cause unexpected fluctuations in both the balance sheet and the profit and loss account as illustrated below, where a swing in exchange rates moves the group from having positive to negative shareholders funds.

Impact of translation differences

Opening exchange rate	£1=\$1.50		
Balance sheets at start of year	Parent £'000	Subsidiary \$'000	Consolidated £'000
Operating assets	500	1500	1500
Investment in US subsidiary at cost	1100		0
Long term liabilities	(1,500)		(1,500)
Consolidation Goodwill			100
	100	1500	100
Shareholders funds	100	1500	100
	100	1500	100

For simplicity, assume no profits during year

Closing exchange rate	£1=\$2.00		
Balance sheets at end of year	Parent £'000	Subsidiary \$'000	Consolidated £'000
Operating assets	500	1500	1250
Investment in US subsidiary at cost	1100		0
Long term liabilities	(1,500)		(1,500)
Consolidation Goodwill			100
	100	1500	(150)
Shareholders funds	100	1500	100
Loss on translation			(250)
	100	1500	(150)

2 Situations where 100% translation risk hedging is vital

The above numerical illustration is of course an extreme case. However, sometimes a corporate simply cannot afford any fluctuations in its consolidated net worth.

For example, it may have a banking covenant that requires it to maintain a particular level of consolidated shareholders funds. If the actual amount is close to the level at which default would arise, then a small adverse movement in foreign exchange rates could reduce its reserves by a sufficient amount to put the company into default. In such a case, it would appear reckless not to hedge 100% of the balance sheet translation risk.

With most corporates however, the position will be much less clear cut. The company may in practice have a very wide degree of discretion regarding the policy it chooses to follow. If it has this freedom of action, what should it do?

3 A theoretical example

When theoretical physicists find a problem in the real world too difficult to calculate, one common approach is to address a much simpler hypothetical problem to see if working with that abstract model provides any insight into the real world. From our school days, most of us can remember a universe of point masses moving without friction, frictionless pulleys and perfectly elastic springs. This type of simplification allows you to focus on the theoretical issues without getting bogged down in endless calculations or uncertainties arising from imperfect information.

a Case study

On 1 January 2006, Company A plc decides that it wants to make an investment which will pay it a cash return of £100 million in exactly ten years time. It wishes to make a single investment today to achieve that return and wants freedom from reinvestment risk (the risk that arises from intervening cash flows that cannot be reinvested at the originally expected rate of return). It is assumed to have only four alternative courses of action available:

1. Purchase a ten year risk free sterling zero coupon bond.
2. Purchase a ten year risk free dollar denominated zero coupon bond.
3. Purchase a ten year sterling zero-coupon bond issued by London Company Plc. The redemption yield on these bonds is presently 70 basis points above the risk free rate and Company A plc is perfectly willing to accept the credit risk involved in investing in such corporate bonds.
4. Invest in a Chicago Co Inc ten year dollar denominated zero coupon bond which is quoted at a yield of 90 basis points over the dollar risk free rate. Again Company A plc is happy to accept the credit risk from investing in Chicago Co's bonds.

To avoid distraction from tax effects, the UK and the USA have abolished taxation.

Table 1 sets out the state of the markets on 1 January 2006.

TABLE 1

Assumed facts at 1 January 2006

1.75	Sterling / dollar spot exchange rate
5%	Sterling one year risk free interest rate
7%	Sterling ten year risk free interest rate
3%	Dollar one year risk free interest rate
6%	Dollar ten year risk free interest rate
7.7%	Redemption yield on London Company PLC's 10 year sterling zero coupon bonds ie 70bp over risk free rate
6.9%	Redemption yield on Chicago Company Inc's 10 year dollar zero coupon bonds ie 90 bp over risk free rate
	There is no taxation in the UK or the USA

Table 2 sets out some relationships that can be derived from the assumed facts.

TABLE 2

Derivations from facts assumed at 1 January 2006

1.7167	Sterling / dollar one year forward exchange rate
1.5932	Sterling / dollar ten year forward exchange rate
6.3387%	Nine year dollar risk free interest rate expected to prevail on 31 December 2006
7.2246%	Nine year sterling risk free interest rate expected to prevail on 31 December 2006

In particular, if you know the spot rate of exchange and the ten year risk free rates for sterling and the dollar, you can compute the ten year forward exchange rate. I appreciate that as you go further into the future, the forward contracts market becomes less liquid and the pricing less perfect but for simplicity this is ignored.

Table 3 summarises the investment alternatives available to Company A plc if it wishes to have £100 million in ten years time without incurring reinvestment risk.

All monetary amounts stated in the table below and the other tables are in millions.

TABLE 3

Initial investment by Company A plc on 1 January 2006

£	100	Sterling amount Company A plc wishes to have in 10 years, without incurring reinvestment risk
£	50.8349	Investment required if invest in risk free instruments
£	47.6259	Investment required if invest in London Company PLC's 10 year corporate bonds
	\$81.7489	Dollar investment needed in Chicago Company Inc's zero coupon bonds
£	46.7137	Sterling cost of this investment in Chicago Company Inc's bonds, since buy dollars at spot rate
		UK corporate is comfortable with the credit risk. It buys the Chicago company zero coupon bonds.
		All FX risk is eliminated by selling the expected maturity value forwards.
		Unless there is a default, Company A plc will have the sterling it desires in 10 years
	7.9085%	Yield to maturity of synthetic sterling investment

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Investing in risk free instruments requires just over £50 million but Company A plc is willing to accept the credit risk represented by London Co Plc then the cost falls to £47 million. However, the lowest cost alternative is for Company A plc to purchase sufficient zero coupon bonds of Chicago Co Inc to provide the dollar equivalent of £100 million in ten years time, where that dollar equivalent is calculated using the ten year forward rate.

The strategy is then for Company A plc to purchase these dollar denominated bonds at a cost of just over \$81 million and to forward sell the dollars to be received in 2016. In this manner, Company A plc locks into a fixed £100 million sterling receivable in 2016, at a cost of just over £46 million, where the only risk involved is the credit risk that Chicago Co Inc may default. It is assumed that the forward contract is itself risk free, either because the counterparty has an unimpeachable credit rating or because the forward is fully margined. One way to look at it is that Company A plc now has a synthetic ten year sterling zero-coupon bond with a cost of £46.7 million and a yield to maturity of just over 7.9%.

b Accounting

Company A plc's accounting for this investment structure would be straight forward if it were to apply UK GAAP as it stood before FRS 26. It would account for the dollar bond and the combined forward as if it owned a synthetic sterling zero coupon bond while the forward contract remained entirely off balance sheet. Table 4 shows the accounting entries for the year 2006.

TABLE 4

Accounting by Company A plc for 2006 if apply pre FRS 26 UK GAAP

£	3.6943	Discount accrued for the year in 2006 P/L account
£	50.4080	Carrying value for bonds in 31 December 2006 B/S

The accounting becomes more complex under International Financial Reporting Standards (IFRS) and UK GAAP FRS 26 adopters.

First of all, assume that for some reason the forward contract is not designated as a hedge. Table 5 shows the assumed developments during 2006 in the external markets so that the spot rate of exchange for example, changes to 1.8 by 31 December 2006.

TABLE 5

Real world changes in circumstances at 31 December 2006

1.8	Sterling / dollar spot exchange rate
7.5%	Nine year dollar risk free interest rate
7.2246%	Nine year sterling risk free interest rate ie sterling rates exactly as expected
7.9246%	Redemption yield on London Company PLC's 9 year sterling zero coupon bonds ie same 70bp spread over risk free rate
8.4%	Redemption yield on Chicago Company Inc's 9 year dollar zero coupon bonds ie same 90 bp spread over risk free rate

Derivations from facts assumed at 31 December 2006

1.8420	Sterling / dollar nine year forward exchange rate
1.7750	Average exchange rate for the year, assuming rates moved smoothly

The Chicago Co Inc zero-coupon bonds are treated as being 'held to maturity' so that each year Company A plc accrues part of the discount on the bonds. It also restates its dollar denominated investment into sterling at each balance sheet date by applying the spot exchange rate to the accounting carrying value of the investment as calculated in dollars. Meanwhile, the forward contract being a derivative is always carried at fair value.

With the assumed market conditions, by 31 December 2006 Company A plc has to record an accounting gain of just over £7 million on the forward contract since exchange rate movements have made it become very valuable as shown in Table 6.

TABLE 6

IFRS accounting by Company A plc for 2006, assuming no hedging designations

£	3.1778	P&L Discount on dollar bonds earned during year
-£	1.3417	P&L foreign exchange loss from restating dollar denominated investment
£	7.2120	P&L gain on forward contract, as derivatives always carried at fair value
£	9.0481	P&L total profit for the year
£	7.2120	B/S Forward contract stated at fair value
£	48.5498	B/S Dollar bonds stated at accreted dollar value converted at closing spot rate
£	9.0481	Check accounts balance: gain on forward + increase in carrying value of bonds from 1 January

While Company A plc's total profit over the ten year period is fixed, this accounting under IFRS can cause significant volatility from year to year e.g. in 2006 the company records a profit of £9 million, most of which represents an acceleration of profit that would otherwise have been accrued over the remaining nine years of the contract.

It is more realistic to have the forward contract designated as a hedge. What the contract is doing is protecting Company A plc against the risk that the cash flow from the bonds (the single dollar receipt in 10 years time) proves to be a different sterling amount from that originally expected. Accordingly, it seems most appropriate to designate the forward contract as a cash flow hedge of the bond cash flows.

Accordingly, at 31 December 2006 the forward contract is carried on the balance sheet at fair value, as derivatives always are. Table 7 shows that the accounting gain is initially taken to equity (ie shareholders funds or reserves) in full.

TABLE 7

IFRS accounting by Company A plc for 2006, with forward designated as a cash flow hedge of dollar receipt due in 10 years time

Profit and loss account		
£	3.1778	P&L Discount on dollar bonds earned during year, translated at average rate
-£	1.3417	P&L foreign exchange loss from restating dollar denominated investment
£	1.8582	Gain on forward contract recycled to P&L
£	3.6943	Profit for the year
Balance sheet - assets		
£	7.2120	Forward contract stated at fair value
£	48.5498	Dollar bonds stated at accreted dollar value converted at closing spot rate
£	55.7617	Total assets
Balance sheet - shareholders funds		
£	46.7137	Opening equity = original sterling investment in Chicago Company Inc bonds
£	7.2120	Transfer to equity, increase in value of derivative designated as a cash flow hedge
-	1.8582	Recycle to P&L an appropriate amount
£	3.6943	Retained profit for the year
£	55.7617	Closing equity

Meanwhile, the bonds are carried at amortised cost, with one year's accrual of the dollar discount, and on the closing balance sheet the accrued dollar amount of the bonds is translated into sterling at the closing rate of exchange.

One then recycles part of the gain on the forward contract from equity back to the profit and loss account. The amount recycled should be that needed to eliminate the variability in the P&L account due to the hedged risk. Of course, no cash has hit the P&L account, but the P&L account does show the impact of retranslating the bonds at a different exchange rate, as well as translating the accruing dollar discount at the average rate for the year. It seems sensible to compute the amount to be recycled such that the profit for the year is the same as under pre FRS 26 UK GAAP. The profit would then be the same as computed assuming a synthetic sterling zero coupon bond. In particular, this ensures that over the ten years the profit each year represents just the return originally expected. Furthermore, the amounts recycled will numerically equal the aggregate gains and losses recorded on the forward contract.

In passing, one of the most natural ways for Company A plc to want to account under IFRS would be to make use of the fair value option for its investment in bonds. If this was possible, the bonds would be carried at fair value with differences taken to the profit and loss account as in Table 8.

TABLE 8

IFRS accounting by Company A plc for 2006, fair value option chosen for investment in bonds

£	46.7137	Opening value of bonds in sterling
£	-	Opening value of forward contract
£	46.7137	
£	42.8275	Closing value of bonds, as stated on balance sheet, market value in dollars translated at spot rate
£	7.2120	Closing value of forward contract, as stated on balance sheet
£	50.0395	
3.3258		Profit for the year, being the change in fair values = actual economic gain during the year

The consequence is that the accounting profit each year actually records the economic gain or loss for that year. However, the scope for opting to carry the bonds at fair value with differences taken to the profit and loss account is circumscribed by accounting standards.

IAS 39 states that it can only be used to “eliminate or significantly reduce a measurement or recognition inconsistency (sometimes referred to as 'an *accounting* mismatch') that would otherwise arise from measuring assets or liabilities or recognising gains and losses on them on different bases.” In other words you cannot use it solely because you have an economic hedge that fails hedge accounting.

In this case, without using the fair value option, the net exposure in the P&L is due to movements in the US\$/£ interest margin (ie the forward points) on the forward - since the bond will be retranslated at the current spot rate which should offset the impact of spot rate movements on the fair value of the forward.

If the fair value option is used, then the net exposure in the P&L will be due to movements in the sterling interest rate - since the movements in the \$ interest rate on the bond will offset the movements on the \$ leg of the forward. Similarly the impact of movements in the spot forex rate on the bond and forward will offset in the P&L.

Therefore from an accounting perspective, the use of the fair value option would replace volatility due to the \$/£ interest margin with volatility due to changes in sterling interest rates. While the correlation of dollar and sterling long term interest rates is imperfect, nevertheless it could be the case that one is increasing the accounting mismatch by using the fair value option, rather than reducing it. In any event I think that it would be hard to argue that it 'significantly reduces' the measurement mismatch. Accordingly, Company A plc is unlikely to be able to make use of the fair value option to account for the investment in the bonds.

c Hedging bond translation risk

After this preliminary look at Company A plc's investment in Chicago Co Inc's zero-coupon bonds hedging them with a ten year forward contract, it is now appropriate to consider what happens if Company A plc purchases the dollar denominated bonds and instead decides to hedge their translation risk.

The initial transaction is summarised in Table 9.

TABLE 9

Translation risk hedging of bond investment for 2006 period only

\$87.3896	Projected 31 December 2006 dollar accounting value of bonds
	On 1 January 2006, take out one year forward to sell this amount of \$ in exchange for sterling
£ 50.9065	Sterling to be received on 31 December 2006 at one year forward rate
£ 2.3568	Cash received on 31 December 2006 on closing out one year forward contract

Having purchased the bonds for \$81.7 million as stated in Table 3, Company A plc calculates that their accounting value on 31 December 2006 will be \$87.3 million as stated in Table 9. Since this amount will be translated into sterling for the purposes of the 31 December 2006 balance sheet, Company A plc hedges this translation risk by forward selling that amount of dollars for sterling under a one year forward contract. Under this contract, on 31 December 2006 Company A plc is due to deliver \$87.3 million and receive £50.9 million.

As stated in Table 5, by the time that 31 December 2006 arrives, spot exchange rates have changed so that when this one year forward contract is closed out, Company A plc receives a net cash amount of £2.3 million. The IFRS accounting is summarised in Table 10 with a total profit of £4.1 million.

TABLE 10

IFRS accounting by Company A plc for 2006, one year translation risk hedge with forward contract

£ 3.1778	P&L Discount on dollar bonds earned during year
-£ 1.3417	P&L foreign exchange loss from restating dollar denominated investment
£ 2.3568	P&L gain on closing out one year forward contract
£ 4.1929	P&L total profit for the year
£ 2.3568	B/S cash received after closing out one year forward contract
£ 48.5498	B/S Dollar bonds stated at accreted dollar value converted at closing spot rate
£ 4.1929	Check accounts balance: cash from closing forward + increase in carrying value of bonds from 1 January

This represents the gain on the forward contract and the discount accrued on the dollar bonds plus the exchange loss on restating the dollar denominated investment. The gain on the forward contract exceeds the foreign exchange loss on the bonds, primarily because our simplified accounting has not taken separate account of the forward points involved in the forward contract.

The key point is that while Company A plc's one year hedging strategy makes accounting sense in terms of avoiding translation risk, it is not economically rational when you take into account Company A plc's original stated projective of ensuring it receives £100 million in ten years time subject only to credit risk. As shown in Table 11, at 31 December 2006 Company A plc is no longer capable of achieving its original investment goal.

TABLE 11

Can the company at 31 December 2006 accomplish its goal of having its target amount of cash at 1 January 2016 with no reinvestment risk?

£ 86.4886	Sterling to be received on 1 January 2016 if now hedge Chicago Company Inc bonds using 9 year forward contract
£ 4.7594	Sterling to be received on 1 January 2016 if now invest cash from closing 1 year forward in Chicago Company Inc bonds and hedge using 9 year forward contract
£ 91.2480	Total sterling proceeds in 2016 with no further market or FX risk, leaving only the credit risk of Chicago Company Inc

Even if it now takes out a nine year forward contract to hedge the bonds it owns against foreign exchange risk for the remainder of their life and also reinvests the cash of £2.3 million obtained on the close out of the one year forward contract and hedges that risk, it will still fall short. Under this revised strategy the most it can achieve in 2016 is £91.2 million.

d Conclusions from the hypothetical example

As Company A plc wishes to receive a single fixed amount of money in ten years time, it is entirely rational to purchase a zero-coupon bond which gives rise to just one cash flow receipt at the end of its life. Where this bond is nominated in foreign currency, Company A plc should forward sell the single foreign currency receipt to guarantee the amount of sterling it will achieve. Conversely, hedging the translation risk represented by the accounting carrying value of the dollar denominated zero coupon bond during its holding period is completely irrational.

The first reaction may be 'so what?' In the real world very few instances arise where you are investing to realise a single cash flow at a fixed point in time. The first change towards greater realism is to substitute investing in a dollar denominated zero-coupon bond with investing in a normal dollar denominated coupon bond which pays fixed periodical interest payments each year with a final repayment at the end of the bond's life. By now, it is intuitively obvious that the sterling based investor should enter into forward contracts to forward sell each dollar cash flow that will be received taking into account both the amount of dollars to be received and the date on which they will arise. While the arithmetic is more complicated than for the zero-coupon bond, it is clear that the logic is exactly the same as for investment in Chicago Co Inc. Again it would be irrational for a sterling based investor to instead hedge the translation risk of the bond investment.

4 But what about subsidiary companies?

Unlike the case of purchasing a bond, when a UK parent has a foreign owned subsidiary it does not know the future cash flows that it will receive in the form of dividends from the subsidiary or indeed the ultimate sale price of the subsidiary if it is sold. What is uncertain is both the amount of these future cash flows and their timing.

As one projects a few years into the future, the level of uncertainty becomes so great that any strategy based on forward selling the future dollar cash flows using fixed forward contracts becomes unrealistic. In these circumstances, should the UK parent revert to a strategy of translation risk hedging?

One theoretical argument would be that, at least at the date that one purchases a foreign subsidiary, the price paid in dollars equals the net present value of the future dollar denominated cash flows to be derived from the ownership of that subsidiary, being the basic theory of investment valuation. Accordingly, by hedging this amount back into sterling the company is indirectly creating a sterling hedge for the net present value of the future dollar cash flows to be received from this American subsidiary, no matter how indeterminate in amount and time those dollar cash flows may be.

This argument is attractive at the point in time when the foreign subsidiary is purchased, but with the passage of time it becomes less persuasive. The accounting convention is that the foreign subsidiary will be carried at its fixed cost in sterling under IFRS, or, less commonly, companies may account for the foreign subsidiary at fair value (as an 'Available for Sale' financial asset) in accordance with IAS 39. However, in the former case after a few years it is quite unlikely that the accounting carrying value of the subsidiary will represent the market value if that subsidiary were to be sold. It is the market value that is the theoretical equivalent of the net present value of the future dollar cash flows to be generated from it. Accordingly, hedging the translation risk (which means hedging the accounts carrying value of the subsidiary) ceases to be supportable by economic arguments even if it was plausible as a strategy at the date that the foreign subsidiary was first purchased.

5 Hedging can also create risk

The other argument against hedging translation risk is that hedging itself can be risky, with the risk level varying with the hedging instruments used.

If you own a large foreign subsidiary, this investment may or may not be realisable by sale depending upon market conditions. However, if you hedge the accounts carrying value, e.g. by one year forward contracts, at each rollover date you will potentially have a significant cash flow receipt or payment as the old hedge matures and the new hedge is placed. This cash flow transaction on the hedge potentially creates its own liquidity and bankruptcy risks.

A safer approach would be to hedge by taking out a long term foreign currency borrowing. This obviates the need to pay out cash on a regular basis when using forward contracts that happen to require settlement payments because the foreign currency has strengthened. If the loan is not needed as a source of finance, it would normally be undesirable to retain the cash borrowed as an asset on the balance sheet, thereby "grossing up" the balance sheet.

In such a case, it would appear natural to use a long term currency swap, with periodical interest payments by each party. From a risk reduction perspective, it would be preferable to have such a swap not margined, as otherwise margin call payments risk creating the same cash flow risk mentioned above in connection with short term forward contracts. Of course, not margining the swap creates counterparty risk should the swap become in the money, demonstrating that there is rarely a simple risk-free strategy.

On balance, the lowest risk hedging strategy appears to be hedging translation risk by taking out long term foreign currency loans, but it helps to have an intended use for the cash. Of course, the easiest use is to finance the original acquisition of the foreign subsidiary, and in practice most groups would address the question of translation risk hedging when buying the foreign company.

I am not aware of any large corporates that have been embarrassed by the cash flow implications of rolling over translation risk hedges. However, there have been many cases where other similar hedging strategies have become unstuck e.g. if a gold mining company chooses to forward sell the gold that it will produce over an extended period of time, then if the price of gold rises a very material cash outflow will arise when the hedging contracts have to be rolled over.

6 Conclusions

After using the very simplified theoretical example discussed above as an aid to thought, what approach would I take to translation risk?

- Sometimes, for company specific reasons such as net worth covenants at risk of being breached, it is vital to hedge against translation risk.
- With a subsidiary company, the theoretically preferred approach of projecting the cash flows that the UK parent company will receive from the subsidiary, and forward selling those into sterling, is not feasible. Unless the subsidiary is to be sold soon, the time horizon is essentially infinite. As well as making forecasting impossible, there is no scope for buying currency forward for indefinite future periods.
- The approach that I find most theoretically appealing is to estimate the market value of the foreign subsidiary in its foreign currency, and to then hedge that amount into sterling. The market value of the subsidiary will rarely coincide with the accounts carrying value, except on or shortly after it is first purchased. Where the market value is similar to the accounts carrying value, this hedging strategy will look like translation risk hedging, and indeed for accounting purposes the parent company may choose to designate (all or a part of) the hedging instrument as a “net investment hedge” in the group accounts. However, the logic behind the approach is to hedge the market value, not the accounts value.
- If a hedge is taken out, whether to hedge the accounts carrying value or the market value, the company needs to ensure that it will not face any cash-flow problems when the hedge needs to be rolled over.
- Where a group has debts, it appears appropriate to incur the debt in sterling and foreign currencies, in proportion to the market value of the group’s assets. While accounts carrying value is a limited surrogate for market value, pro-rating debt in proportion to net assets still seems more logically appealing than incurring all borrowing in sterling.
- I am attracted by the argument that in the long run foreign exchange rates reflect purchasing power parity and the intervening fluctuations (albeit sometimes very long lived) represent nothing more than noise. As a hedging strategy inevitably involves some element of external costs, this would point towards not hedging at all. However, one needs to be willing to take a long term view, which may be longer than the time horizons of most shareholders or finance directors. At a purely personal level, I do not hedge my own US share portfolio.
- If the foreign operations are so major that the accounting effect of translating those foreign operations into sterling is to produce undesirable accounting volatility, and are predominantly in one foreign currency, a good solution may be for the UK group and hence the parent to adopt the foreign currency, usually the dollar, as the currency of its accounts. This has indeed been done by several large oil companies and by a UK based global bank. Of course, you then need to consider whether to hedge the group’s sterling operations!

Should companies hedge against translation risk?
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