

# The Fall of the Euro and Its Impact on Oracle® E-Business Suite

an eprentise white paper



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As of the writing of this article, media is reporting that due to voters narrowly casting in favor of the pro-Eurozone party, the “drachmageddon”, or Greece pulling out of the Euro, has been avoided – for now. That said, sources report that Greece will run out of money by the end of July, once again raising the specter of a Greek debt default and requiring a bailout package from its Eurozone partners. One thing is clear: the cycle of bailout and bailout again is not sustainable in the long term. Worse, this cycle is not limited to Greece, with Spain having just received its own multi-billion Euro bailout of its banking system, and other countries in the Eurozone, notably Ireland, Italy, Portugal, and Belgium, also in economic trouble. As a result, the collapse of the Euro as a unified currency is no longer just an academic musing, but is in fact a reasonable possibility.

Taken as a whole, the Eurozone makes up approximately 19% of both total world GDP and world trade. To put this into perspective, the US makes up just about 20% of total world GDP and 17% of world trade. Given the enormous financial impact of a Eurozone breakup, it is to be expected that global companies with significant European operations or sizeable European trading partners are putting contingency plans in place to mitigate the negative impact of such a breakup.

A key part of the contingency planning for companies using Oracle E-Business Suite is to develop an ERP plan for a partial or complete collapse of the Euro. The scope of this plan should include the possibility of the incremental unraveling of the Euro, with consideration given to the countries most likely to exit the Eurozone. These countries are termed “weak” Eurozone countries and include Greece, Ireland, Italy, Portugal, Spain, and Belgium. Consideration and planning should also occur around the possibility that the Euro may completely collapse with all participating countries returning to their own national currencies.



Before discussing contingency planning, it is important to understand how EBS accounts for multi-currencies.

## Overview of EBS Multi-Currency Accounting

Currencies are configured within EBS at the set of books, or for R12, at the ledger level. Then individual countries are accounted for as legal entities within the set of books. It is important to understand that individual currencies cannot be assigned at the legal entity level. Since the Euro is the unified currency for the Eurozone countries, many companies account all LEs within a single set of books. From a data and transactional processing standpoint, using one set of books for all countries on the Euro is very efficient and has been considered a best practice, but will of course only work if all LEs within the set of books remain on the same functional currency.

Oracle EBS works with multiple currencies on two levels, functional and entered. Functional currency is defined as the primary accounting currency for a given set of books (ledger). Each set of books (ledger) can only have one functional currency. However, to accommodate the fact that a global company will have a need to account for transactions in multiple currencies, EBS also allows the assignment of entered currencies. For example, consider a company incorporated in France (call it Widgetco) with a functional currency as the Euro. When Widgetco transacts with an entity in Euros, the transaction is accounted for in the functional currency at just one level. But what happens when the transaction is with an entity using another currency? This is where the entered currency comes in. Let's say Widgetco makes a sale to a company in Norway and the transaction is in Norwegian krone (NOK). When the sale is made, the entry into accounts receivable and revenue is made in NOK. EBS automatically converts the transaction to EUR, the functional currency.

The following example illustrates a typical revenue/accounts receivable transaction using two different currencies, the Euro as the functional currency and the Norwegian krone (NOK) as the entered currency.

In this example a sales of 1,000 NOK is made, and the collection of the related accounts receivable is also in NOK.

### NOK to Euro, no currency exchange to EUR

**Sale 1,000 € (1.60 NOK to EUR, 1000/1.60)**

	Entered Currency (NOK)	Functional Currency (EUR)
<b>Accounts Receivable</b>	1,000	625
<b>Revenue</b>	1,000	625
<b>Foreign Exchange (Gain/Loss)</b>	0	0

**AR Collected (1.25 NOK to EUR, 1000/1.25)**

	Entered Currency (NOK)	Functional Currency (EUR)
Cash (Euro)	1,000	800
Accounts Receivable	1,000	625
Foreign Exchange (Gain/Loss)		175

In this case, no foreign exchange gain or loss is recognized for either the entered or functional currency when the sale is initiated or accounts receivable is recognized. However, when AR is actually collected, there is a gain or loss (foreign exchange) recognized in only the functional currency.

Things are accounted for a little differently if the invoice is paid for in NOK but there is an actual currency exchange (i.e., the payment in NOK is exchanged by a bank for EUR). As an example—

**NOK to Euro, currency exchange to USD**

**Sale 1,000 € (1.60 NOK to EUR, 1000/1.60)**

	Entered Currency (NOK)	Functional Currency (EUR)
Accounts Receivable	1,000	625
Revenue	1,000	625
Foreign Exchange (Gain/Loss)	0	0

**AR Collected (1.25 NOK to EUR, 1000/1.25)**

	Entered Currency (NOK)	Functional Currency (EUR)
Cash (USD)	800	800
Accounts Receivable	1,000	625
Foreign Exchange (Gain/Loss)	200	175

In this case, no foreign exchange gain or loss is recognized for either local or functional currency when the sale is initiated and accounts receivable is recognized. However, when AR is actually collected, there is a gain or loss (foreign exchange) recognized in both the entered and functional currencies. There is a loss recognized in the entered currency of 200 (NOK), and there is a gain recognized in the functional currency of 175 (EUR).

Although the foregoing examples are simple while currency transactions can be quite complex, it gives a general idea of how accounting in the entered and functional currency are affected.

**Planning for a Change in Functional Currency**

In general, there are three distinct possibilities for the Euro and the respective Eurozone countries. The first is that the Euro will continue as a unified currency for participating Eurozone countries. This would be ideal, but there are indicators that this is unlikely in the long term. The more likely scenario is that only certain countries will exit the Euro. The last possibility is that the Euro will collapse in entirety with all Eurozone countries reverting back to their legacy currencies.

The first possibility, the Euro continuing as a durable currency with no Eurozone members exiting, requires little contingency planning from an Oracle EBS standpoint. The second possibility, a few countries exiting the unified Euro currency – the more likely scenario – requires more extensive contingency planning. The third, full collapse of the Euro as a durable, ongoing currency requires additional planning.

For both scenarios two and three, the steps in contingency planning are actually the same. Those steps are:

1. Risk Assessment
2. Identification of Options
3. Budgeting and Management Approval

### **Step One: The Risk Assessment**

The first step in mitigating the impact of a possible Euro collapse is performing an assessment of the functional currencies that a company keeps its sets of books in.

To do this, the functional currencies that are currently in use in Oracle EBS systems must be listed.

Currency is associated at the set of books (or ledger in R12) level, so a list of the functional currency being used for each set of books (ledger) should be made. Then within each set of books (ledger), it is important to identify each legal entity and consider the associated country for each. For example, you may have a set of books for which the currency is defined as the Euro, but then within that set of books, there may be a France incorporated legal entity, a Greek incorporated legal entity, a Spain incorporated legal entity, etc.

#### **Steps**

**Step 1:** Identify legal entities (LEs) most at risk.

**Step 2:** Move at-risk entities into a new set of books (SOB) or create a secondary ledger with a new functional currency. Convert balances and open transactions to the new currency.<sup>1</sup>

**Step 3:** Obtain budget approval.

<sup>1</sup> [eprentise Currency Conversion software](#) can make these changes.

For each legal entity, assess the risk that a jurisdictional country might exit the Euro individually. For scenario three, this may mean all Eurozone members. The following table is an abbreviated list of Eurozone countries by risk, as an example of what might be used to make this assessment.

Eurozone country risk scores: No longer in free fall				
Country	ECR Rank Q1 2012	ECR Score Q1 2012	Rank change in Q1	Rank change since March 2010
<i>Finland</i>	5	85.3	1	0
<i>Netherlands</i>	9	83.8	-1	0
<i>Germany</i>	13	81.9	0	-2
<i>Austria</i>	14	81.2	0	-7
<i>France</i>	18	75.1	-1	-6
<i>Belgium</i>	21	71.8	0	-7
<i>Italy</i>	36	63.2	1	-12
<i>Spain</i>	39	61.8	1	-14
<i>Ireland</i>	48	57.3	-2	-27
<i>Portugal</i>	61	52.2	0	-30
<i>Greece</i>	120	33.1	-5	-87

Source: [Euromoney Country Risk](#)

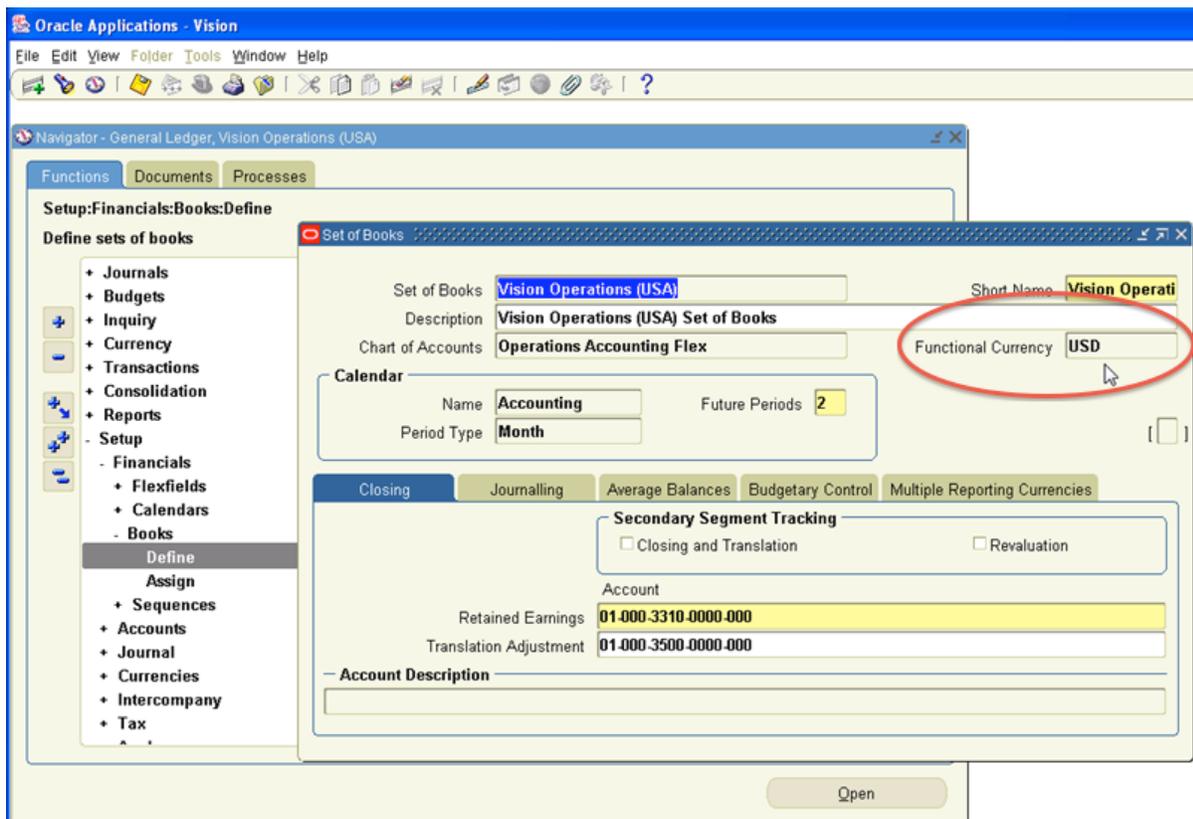
If the Euro unravels, then each of the affected legal entities may have to be given their own functional currency, such as the franc, the drachma, or the peseta. The complicating factor (as mentioned before) is that currency is not defined at the legal entity level; it is instead defined at the set of books (ledger) level, so the options for changing the functional currency on individual LEs are limited.

## Step Two: Identification of Options

If, based on the risk assessment performed in step one, there is a reasonable possibility that some or all of the Eurozone countries will exit the Euro, the EBS options for mitigating the impact of such a change should be examined. For users still on 11i, the options are limited. For users of Release 12, the functionality of secondary ledgers can accommodate a more elegant switch from the Euro.

### Options for 11i Users

Because currency is defined only at the set of books level, for 11i users, each legal entity that is being affected by a country or countries exiting the Euro must be changed to a new functional currency (assumed to be the legacy currency used prior to the introduction of the Euro).



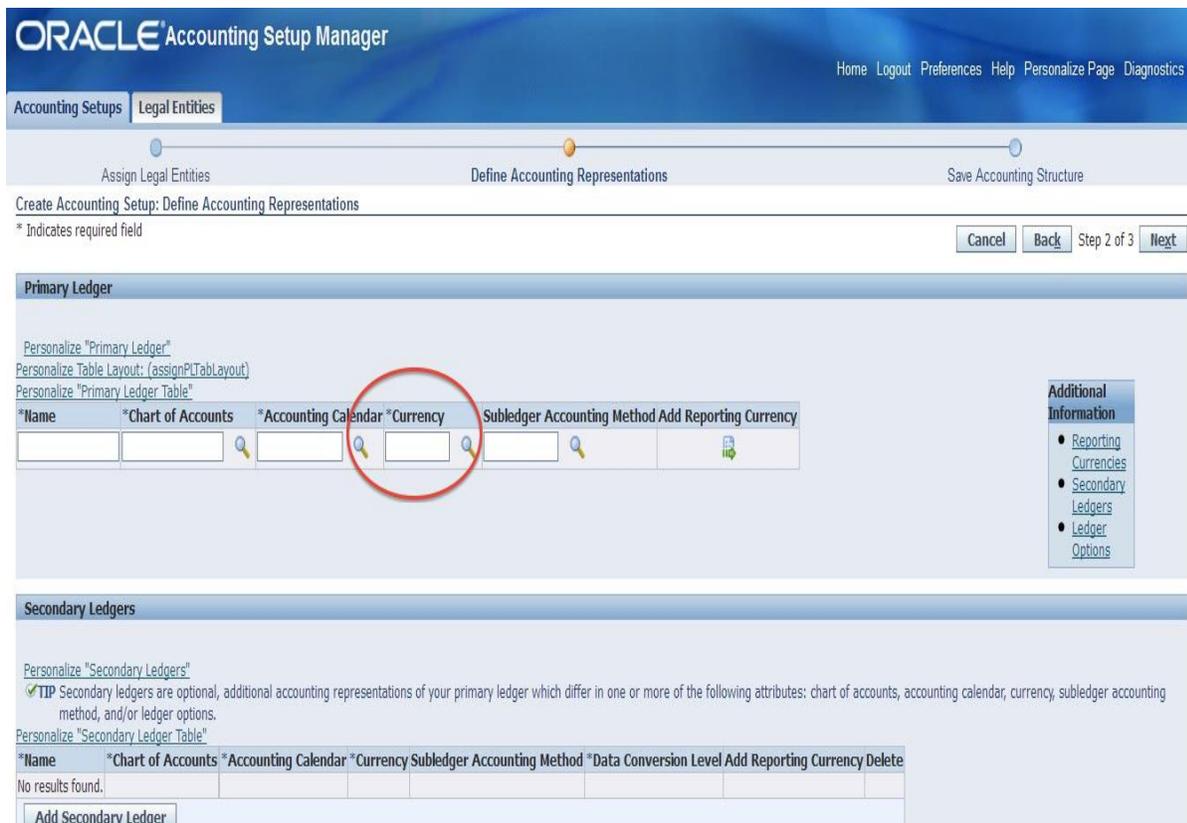
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Functionally, there are a few choices for doing this. Software is available that can effect this change, moving the legal entity to a new set of books, converting the functional currency, and preserving all history. Alternately, a new set of books can be established for prospective transactions with the new currency defined, but this requires significant work to migrate carry-forward balances and outstanding transactions over to the new set of books. For all carry-forward transactions and balances, amounts will have to be converted to the new functional currency manually using a GAAP compliant method.

Another option for 11i users is to upgrade to Release 12 and make use of secondary ledgers to effect the currency change.

### Options for R12 Users

Release 12 users have a much more elegant solution for dealing with legal entities that are moving off the Euro. In Release 12, Oracle introduced secondary ledgers. Per the Oracle Financials Implementation Guide, additional ledgers called secondary ledgers can optionally be assigned to an accounting setup to maintain multiple accounting representations for the same legal entity.



Click image for larger view.

By using secondary ledgers, it is possible to have a separate functional currency for each legal entity while maintaining a single primary ledger. With secondary ledgers and subledger functionality, it is possible to maintain drill-down capability and bring forward all history. Ideally, use of secondary ledgers should only be an intermediate step, and ultimately the secondary ledger should be promoted to primary ledger status.

### ***Step Three: Budgeting and Management Approval***

Once the risk assessment is performed and the appropriate options have been identified, a tentative work plan should be developed, a budget estimated, and management approval for the plan obtained.

At a minimum, the work plan should include a tentative timeframe, the work steps to be performed, the resources needed (both people and infrastructure), and the project manager and team identified. This work plan will need to be detailed enough to allow a relatively accurate assessment of the project's costs that will form the basis of the budget.

With the work plan, a budget can be developed for the appropriate options. This budget and the supporting work plan should be reviewed and approved by management.

### **Conclusion**

While it seems that the "drachmageddon" has been avoided for now, the possibility of a full or partial collapse of the Euro is still high. In the case of either a full collapse of the Euro as a currency or an incremental exit of certain countries for the unified currency, the impact on companies doing business in Europe will be significant. However, with some forethought and planning, the risks of disruption to your Oracle EBS system can be mitigated.

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**eprentise** provides transformation software products that allow growing companies to make their Oracle® E-Business Suite (EBS) systems agile enough to support changing business requirements, avoid a reimplementations and lower the total cost of ownership of enterprise resource planning (ERP). While enabling real-time access to complete, consistent and correct data across the enterprise, **eprentise** software is able to consolidate multiple production instances, change existing configurations such as charts of accounts and calendars, and merge, split or move sets of books, operating units, legal entities, business groups and inventory organizations.