

## **ED NASCO № 22**

### **The effects of changes in foreign currency rates**

#### **Purpose of Standard**

1. This Standard has been prepared in accordance with the Accounting Law of the Azerbaijan Republic and is based on International Accounting Standard 28 “Accounting for Associates”.

#### **Objective**

2. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

#### **Scope**

3. This Standard will be applied by all types of commercial enterprise that prepare financial statements in accordance with Article 10 of the Accounting Law of the Azerbaijan Republic, taking into account the additional provisions contained in the Explanations and Recommendations on its Application
4. In the case of contradictions between effective normative-legal Acts on accounting regulation and this National Accounting Standard, the National Accounting Standard should be applied.
5. This Standard shall be applied:
  - (a) in accounting for transactions and balances in foreign currencies;
  - (b) in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation; and
  - (c) in translating an entity's results and financial position into a presentation currency.
6. Foreign currency derivatives are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.
7. This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation.
8. This Standard applies to the presentation of an entity's financial statements in a foreign currency and sets out requirements for the resulting financial statements to be described as complying with National Accounting Standards. For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.
9. This Standard does not apply to the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (see NASCO 5 Cash Flow Statements).

## Definitions

10 The following terms are used in this Standard with the meanings specified:

*Closing rate* is the spot exchange rate at the balance sheet date.

*Exchange difference* is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

*Exchange rate* is the ratio of exchange for two currencies.

*Foreign currency* is a currency other than the functional currency of the entity.

*Foreign operation* is an entity that is a subsidiary, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.

*Functional currency* is the currency of the primary economic environment in which the entity operates.

*Monetary items* are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.

*Net investment in a foreign operation* is the amount of the reporting entity's interest in the net assets of that operation.

*Presentation currency* is the currency in which the financial statements are presented.

*Spot exchange rate* is the exchange rate for immediate delivery.

## Reporting foreign currency transactions in the functional currency Initial recognition

11 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

- (a) buys or sells goods or services whose price is denominated in a foreign currency;
- (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
- (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

12 A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction

13 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with National Accounting Standards. For practical reasons,

a rate that approximates the actual rate at the date of the transaction is often used. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate

### **Reporting at subsequent balance sheet dates**

- 14 At each balance sheet date:
- (a) foreign currency monetary items shall be translated using the closing rate;
  - (b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and
  - (c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined.
- 15 The carrying amount of an item is determined in conjunction with other relevant Standards. For example, property, plant and equipment may be measured in terms of fair value or historical cost in accordance with NASCO 7 Property Plant and Equipment. Whether the carrying amount is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this Standard.
- 16 The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories is the lower of cost and net realisable value in accordance with NASCO 7 Inventories. When such an asset is non-monetary and is measured in a foreign currency, the carrying amount is determined by comparing:
- (a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (ie the rate at the date of the transaction for an item measured in terms of historical cost); and
  - (b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date when that value was determined (eg the closing rate at the balance sheet date).
- The effect of this comparison may be that an impairment loss is recognised in the functional currency but would not be recognised in the foreign currency, or vice versa.
- 17 When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

### **Recognition of exchange differences**

- 18 Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognised in profit or loss in the period in which they arise, except as described in paragraph 21.
- 19 When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent

accounting period, the exchange difference recognised in each period up to the date of settlement is determined by the change in exchange rates during each period.

- 20 When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss shall be recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.
- 21 Other Standards require some gains and losses to be recognised directly in equity. For example, NASCO 7 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognised directly in equity. When such an asset is measured in a foreign currency, paragraph 13(c) of this Standard requires the revalued amount to be translated using the rate at the date the value is determined, resulting in an exchange difference that is also recognised in equity.
- 22 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity, such exchange differences shall be recognised initially in a separate component of equity and recognised in profit or loss on disposal of the net investment
- 23 When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 17. If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements in accordance with paragraph 17. If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements in accordance with paragraph 17. Such exchange differences are reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity.
- 24 When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial statements all amounts are translated into the functional currency in accordance with paragraphs 10-16. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency.

### **Change in functional currency**

- 25 When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change
- 26 Once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions..
- 27 The effect of a change in functional currency is accounted for prospectively. The resulting translated amounts for non-monetary items are treated as their historical

cost. Exchange differences arising from the translation of a foreign operation previously classified in equity in accordance with paragraphs 21 and 28(c) are not recognised in profit or loss until the disposal of the operation.

## **Use of a presentation currency other than the functional currency**

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- 28 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.
- 29 The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
- (a) assets and liabilities for each balance sheet presented (ie including comparatives) shall be translated at the closing rate at the date of that balance sheet;
  - (b) income and expenses for each income statement (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and
  - (c) all resulting exchange differences shall be recognised as a separate component of equity
- 30 For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
- 31 The exchange differences referred to in paragraph 28(c) result from:
- (a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences arise both on income and expense items recognised in profit or loss and on those recognised directly in equity.
  - (b) translating the opening net assets at a closing rate that differs from the previous closing rate.
- These exchange differences are not recognised in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and recognised as part of, minority interest in the consolidated balance sheet.
- 32 The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
- (a) all amounts (ie assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent balance sheet, except that
  - (b) when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as

current year amounts in the relevant prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

## **Translation of a foreign operation**

- 33 Paragraphs 33-35, in addition to paragraphs 27-31, apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation, proportionate consolidation or the equity method.
- 34 The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, (see NASCO 19 *Consolidated and Separate Financial Statements* and NASCO 21 *Interests in Joint Ventures*). However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference continues to be recognised in profit or loss or, if it arises from the circumstances described in paragraph 21, it is classified as equity until the disposal of the foreign operation.
35. When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. When this is not done NASCO 19 allows the use of a different reporting date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the balance sheet date of the foreign operation. Adjustments are made for significant changes in exchange rates up to the balance sheet date of the reporting entity in accordance with NASCO 19.
- 36 Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 28 and 31.

## **Disposal of a foreign operation**

- 37 On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that foreign operation shall be recognised in profit or loss when the gain or loss on disposal is recognised
- 38 An entity may dispose of its interest in a foreign operation through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity. The payment of a dividend is part of a disposal only when it constitutes a return of the investment, for example when the dividend is paid out of pre-acquisition profits. In the case of a partial disposal, only the proportionate share of the related accumulated exchange

difference is included in the gain or loss. A write-down of the carrying amount of a foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised in profit or loss at the time of a write-down.

## **Tax effects of all exchange differences**

- 39 Gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency may have tax effects. NASCO 3 Current Tax and NASCO 4 Deferred Tax applies to these tax effects.

## **Disclosure**

- 40 In paragraphs 40 and 42-44 references to 'functional currency' apply, in the case of a group, to the functional currency of the parent.
- 41 An entity shall disclose:
- (a) the amount of exchange differences recognised in profit or loss; and
  - (b) net exchange differences classified in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
- 42 When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.
- 43 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.
- 44 When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with National Accounting Standards only if they comply with all the requirements of each applicable Standard
- 45 If an entity presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 52 such conversions are not in accordance with National Accounting Standards and the disclosures set out in paragraph 44 are required.
- 46 When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 42 are not met, it shall:
- (a) clearly identify the information as supplementary information to distinguish it from the information that complies with National Accounting Standards;
  - (b) disclose the currency in which the supplementary information is displayed; and
  - (c) disclose the entity's functional currency and the method of translation used to determine the supplementary information.

47. This National Standard for Commercial Organisations becomes operative after the date determined by the Minister of Finance of the Azerbaijan Republic