NAS 11

NEPAL ACCOUNTING STANDARDS ON THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

CONTENTS **Paragraphs**

Nepal Accounting Standard, 11 The Effects of Changes in Foreign Exchange Rates (NAS 11) is set out in paragraphs 1-54. All the paragraphs have equal authority. Paragraphs in **bold italic type** state the main principles. NAS 11 should be read in the context of its objective, the *Preface to Nepal Accounting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. NAS 02 *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. 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.

The principal issues are which exchange rate (s) to use and how to report the effects of changes in exchange rates in the financial statements.

Scope

1. **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 or the equity method; and**
    c. **in translating an entity's results and financial position into a presentation currency.**
2. This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation.
3. This Standard applies to the presentation of an entity's financial statements in a foreign currency. For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.
4. This Standard does not deal with the restatement of an entity's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.
5. 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 NAS 03 *Cash Flow Statements*).
6. This Standard applies to all companies including Public Sector Business Entities.

Definitions

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

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

    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.

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

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

A group is a parent and all its subsidiaries

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.

Elaboration on the definitions

Functional currency

8. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors in determining its functional currency:
   (a) the currency:
      (i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and
      (ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
   (b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

9. The following factors may also provide evidence of an entity's functional currency:
   (a) the currency in which funds from financing activities (ie issuing debt and equity instruments) are generated.
   (b) the currency in which receipts from operating activities are usually retained.

10. The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint venture):
   (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.

(b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.

(c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.

(d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

11. When the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 8 before considering the indicators in paragraphs 9 and 10, which are designed to provide additional supporting evidence to determine an entity's functional currency.

12. An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.

Net investment in a foreign operation

13. An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 28 and 29. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

14. The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 13 may be any subsidiary of the group. For example, an entity has two subsidiaries, A and B. Subsidiary B is a foreign operation. Subsidiary A grants a loan to Subsidiary B. Subsidiary A's loan receivable from Subsidiary B would be part of the entity's net investment in Subsidiary B if settlement of the loan is neither planned nor likely to occur in the foreseeable future. This would also be true if Subsidiary A were itself a foreign operation.

Monetary items

15. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: pensions and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends that are recognised as a liability. Similarly, a contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (eg prepaid

rent); goodwill; intangible assets; inventories; property, plant and equipment; and provisions that are to be settled by the delivery of a non-monetary asset.

Summary of the approach required by this Standard

16. In preparing financial statements, each entity-whether a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch)-determines its functional currency in accordance with paragraphs 8-12. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 18-33 and 46.

17. Many reporting entities comprise a number of individual entities (eg a group is made up of a parent and one or more subsidiaries). Various types of entities, whether members of a group or otherwise, may have investments in associates or joint ventures. They may also have branches. It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 34-46.

Foreign currency transactions

Initial recognition

18. 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.

19. 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.

20. The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with International Financial Reporting Standards. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Reporting at subsequent balance sheet dates

21. 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.***

22. 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 NAS 16 *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.

Recognition of exchange differences

23. This Standard does not deal with hedge accounting for foreign currency items. The application of hedge accounting requires an entity to account for some exchange differences differently from the treatment of exchange differences required by this Standard.

24. 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 28.

25. 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.

26. 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.

27. Other Standards require some gains and losses to be recognised directly in equity. For example, NAS 06 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 21(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.

28. ***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 (eg consolidated financial statements when the foreign operation is a subsidiary), 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 in accordance with paragraph 44.***

29. 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 24. 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 24. 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 24. Such exchange differences are reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (i.e. financial statements in which the foreign operation is consolidated, proportionately consolidated or accounted for using the equity method).

30. 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. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate, and non-monetary items that are measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition.

Change in functional currency

31. ***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.***

32. As noted in paragraph 12, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.

33. The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. 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 28 and 35(c) are not recognised in profit or loss until the disposal of the operation.

Use of a presentation currency other than the functional currency

Translation to the presentation currency

34. 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.

35. 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 (i.e. including comparatives) shall be translated at the closing rate at the date of that balance sheet;

   b. income and expenses for each income statement (i.e. 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.

36. 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.

37. The exchange differences referred to in paragraph 35(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.

38. 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 (i.e. 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).***

39. ***When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements before applying the translation method set out in paragraph 38, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy (see paragraph 38(b)). When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements, it shall use as the historical costs for translation into the presentation currency the amounts restated to the price level at the date the entity ceased restating its financial statements.***

Translation of a foreign operation

40. Paragraphs 41–43, in addition to paragraphs 34–39, 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.

41. The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intra group balances and intra group transactions of a subsidiary. However, an intra group monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intra group 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 28, it is classified as equity until the disposal of the foreign operation.

42. 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, the entity may be allowed for 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. The same approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation to joint ventures.

43. ***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 35 and 38.***

Disposal of foreign operation

44. ***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.***

45. 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

46. 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. NAS 09 applies to these tax effects.

Disclosure

47. ***In paragraphs 48 and 50-52 references to 'functional currency' apply, in the case of a group, to the functional currency of the parent.***

    An entity shall disclose:

    a. ***the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss; and 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.***

48. ***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.***

49. ***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.***

50. ***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 International Financial Reporting Standards only if they comply***

with all the requirements of each applicable Standard and each applicable Interpretation of those Standards including the translation method set out in paragraphs 35 and 38.

51. An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 50. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with International Financial Reporting Standards and the disclosures set out in paragraph 52 are required.

52. 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 50 are not met, it shall:

a. clearly identify the information as supplementary information to distinguish it from the information that complies with International Financial Reporting 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.

Compliance with International Accounting Standards

53. Compliance with this NAS ensures compliance in all material respects with IAS 21- The Effects of Changes in Foreign Exchange Rates.

Effective date

54. This Nepal Accounting Standard becomes operative for financial statements covering periods beginning on or after 01 Shrawan 2065 corresponding to 17 July 2008.