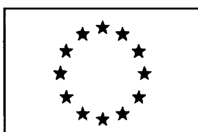
PAPER ON THE ACCOUNTING ADVISORY FORUM

FOREIGN CURRENCY TRANSLATION



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PAPER ON THE ACCOUNTING ADVISORY FORUM
FOREIGN CURRENCY TRANSLATION

DOCUMENT

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PREFACE

This document deals with Foreign Currency Translation. It has been prepared by the Accounting Advisory Forum (Forum) as an advisory document to the Commission. The views expressed in this document do not necessarily represent a Commission's official position.

The Forum is an advisory body of experts from main parties interested in accounting in the European Union. The Forum is not a standards-setting body. Its main function is to advise the Commission on accounting matters and possible ways to facilitate further harmonisation. The members of the Forum are invited on a personal basis. Their opinions, as expressed in this document, do not commit the organisations by whom they have been nominated, nor do they reflect the unanimous view of all the members.

The purpose of this publication is to stimulate discussions among standards-setters, preparers, users and auditors of accounts in Member States on the subject of Foreign Currency Translation. The document examines the various possibilities for furthering the presentation of comparable and equivalent information within the context of the Accounting Directives.

EXECUTIVE SUMMARY

SCOPE

This document deals with the translation of foreign currency items in annual accounts, with the incorporation of foreign branches into the annual accounts and with the translation of annual accounts of foreign operations in the preparation of consolidated accounts. The document does not specifically deal with financial instruments, as the issue is still under debate and is seen as a separate topic. However, the principles set out may under certain circumstances apply accordingly.

DISTINCTION BETWEEN TREATMENT IN ANNUAL AND CONSOLIDATED ACCOUNTS

It is important to recognise that the document differentiates between the treatment of foreign currency translation in the annual and consolidated accounts. One of the main areas of discussion in the Forum on foreign currency translation related to the treatment of unrealised net positive translation differences. Because of differences in points of view as to the purpose of the annual accounts (capital maintenance versus performance measurement) and, consequently, the differences in interpretation of the prudence and matching principles, it appeared difficult to reach consensus on one preferred method for the treatment of unrealised positive translation differences to be used in the annual accounts. Therefore, for the annual accounts three different methods are considered to be acceptable. However, because consolidated accounts are normally not subject to the constraints resulting from capital maintenance (e.g. profit distribution purposes) and taxation requirements, agreement could be reached on one preferred method for the consolidated accounts.

ANNUAL ACCOUNTS

The translation of the annual accounts forms the first part of the Forum paper. For the annual accounts no preference is expressed for the exchange rate to be used in translating foreign currency monetary items. Either the historical rate or the closing rate can be used.

The next topic of discussion relates to set-off of translation differences. This question is discussed in the light of art. 7 in the 4th Directive which prohibits offsetting of assets and liabilities. Also Article 31(1)(e), which states that the components of assets and liabilities should be separately valued, is discussed. The conclusion is that it would be appropriate to set-off all translation differences on short-term monetary items.

In the discussion of the treatment of unrealised positive translation differences that remain after netting against negative differences, three methods are identified. Net positive translation differences can either (i) be included in the profit and loss account, (ii) be deferred under a separate heading in the balance sheet or (iii) not be recognised at all. In the latter case the respective monetary items continue to be valued at

historical rates in the balance sheet. No consensus could be reached on a preferred treatment of net positive translation differences in the annual accounts.

Foreign branches

For incorporation of foreign branches into the annual accounts, the temporal method is recommended. Resulting net positive translation differences may be treated in conformity with one of the three methods described above.

CONSOLIDATED ACCOUNTS

In order to achieve comparability of consolidated accounts, one single method is recommended for the recognition of translation differences in the annual accounts of the parent undertaking as well as for the annual accounts of the subsidiaries included in the consolidation. Whereas for the annual accounts three methods are considered to be acceptable, for the consolidated accounts it is suggested that both positive and negative translation differences be included in the profit and loss account (method iii).

Foreign operations

For subsidiaries to be included in the consolidated accounts, a distinction is made between integrated foreign operations and non-integrated foreign operations. The document contains a number of indicators in order to determine whether a foreign operation is integrated or not.

For the translation of the annual accounts of integrated foreign operations into the reporting currency of the parent, as for the incorporation of foreign branches into the annual accounts, the temporal method is recommended. Whereas for the resulting net positive translation differences in the annual accounts three methods can be used, for consolidation purposes, it is suggested that the resulting net positive and negative translation differences are included in the profit and loss account.

For non-integrated foreign operations preference is given to the closing rate/net investment approach. The essence of this method is that the translation process is undertaken in two stages. First, the individual foreign currency items in the annual accounts of the subsidiary are translated into local currency of that entity. The method to be used is the temporal method with recognition of all translation differences in the profit and loss account. The second stage is the translation of the accounts of subsidiary to be incorporated in the consolidated accounts. The balance sheet items are translated into the reporting currency using the closing rate method. The items of the profit and loss account are translated at the rates existing at the time of transaction (preferred treatment) or at the closing rates. The translation differences that are a result of changes of the exchange rate from one period to another are taken directly to the reserves.

Other aspects

The document recommends special treatment for intra-group monetary-items which represent a part of the net investment and for long term foreign currency debt contracted to finance the capital investment.

DISCLOSURES

The document concludes with a number of recommended disclosures for the annual accounts and for the consolidated accounts.

COMPARISON WITH IAS 21

As far as the consolidated accounts are concerned, the recommendations made in this document are to a large extent in line with International Accounting Standard 21 - 'Accounting for the Effects of Changes in Foreign Exchange Rates'. IAS 21 does not operate a distinction between the treatment of foreign currency translation in the annual and consolidated accounts. From a European point of view, however, as indicated above, making such distinction appears necessary. For this reason, the treatment of foreign currency translation in the annual accounts may, in particular as regards the treatment of unrealised positive translation differences, deviate from IAS 21.

INTRODUCTION

1. To incorporate foreign currency transactions and the accounts of foreign operations in its annual or consolidated accounts, an enterprise must translate into a single reporting currency those assets, liabilities, income, charges, profits and losses that are measured or denominated in a foreign currency because it is not possible to combine, add or subtract measurements in different currencies. This document deals with translation of both foreign currency transactions and the accounts of foreign operations.

2. The internationalisation of economic life causes an increasing number of enterprises to operate in currencies other than their national currency. The fluctuation of currency rates creates an environment of permanent uncertainty, which may have an impact on the assets, liabilities, financial position and results of the enterprises. In order to cope with this situation various financial techniques have been developed to reduce (hedge) an enterprise's exposure to these financial uncertainties. On the other hand some enterprises speculate on foreign currency transactions through creating exposures to these financial uncertainties with a view to making a profit but also with the consequent risk of loss. The applicable accounting rules for operations in a foreign currency should enable the identification of the risks and the manner in which they are (or are not) managed by the company.

3. The European Union addresses the subject of foreign currency translation for a specific sector, the banking sector, in Article 39 of the Bank Accounts Directive (86/635/EEC). For other enterprises, the Fourth and Seventh Directives do not explicitly refer to foreign currency translation except that they require disclosure of the bases of conversion used to express items which are or were originally expressed in foreign currency, into the reporting currency. In view of the fundamental differences of approach of the various Member States, which are reflected in national law (including tax rules) and practice, it may be difficult in the short term to agree on a uniform method of translation.

   This document examines the various possibilities for furthering the presentation of comparable and equivalent information in order to reflect, in conformity with the principles of the Accounting Directives, in the reporting currency of an enterprise the results of its activities, when some of them have been conducted in foreign currencies and when its balance sheet includes items denominated in foreign currencies.

SCOPE

4. This document deals with the translation of foreign currency items in annual accounts, with the incorporation of foreign branches into the annual accounts, and with the translation of annual accounts of foreign operations in the preparation of consolidated accounts. The translation process contains two basic elements each of which is discussed in more detail below:

   - the rate(s) used in translating the various items expressed in foreign currency; and

   - the treatment of the resulting translation differences.

5. This document does not deal with:

(a) Restatement of the accounts of an enterprise from its reporting currency into another currency for the convenience of readers accustomed to another currency or for other similar purposes.

(b) Specific rules on translation for banks and similar financial institutions and insurance companies, as the basic accounting requirements are covered by separate Directives. However, this document does apply to financial institutions and insurance companies unless their particular characteristics require a departure.

(c) The particular characteristics of the growing number of financial instruments used for taking up positions in foreign currency and/or interest. Many of these instruments are not included in the balance sheet but remain off-balance sheet. Currency and interest rate risks are related to such off-balance sheet items, e.g. forward contracts. As far as off-balance sheet items are effectively hedging positions, the risk exposure created by the related on-balance sheet item is set-off. Hedging will be addressed by this document in so far as it relates to translation differences in respect of on-balance sheet items. For items not recognised on the balance sheet this document only indicates that under certain circumstances a provision should be made for possible losses from those items, but this is a general problem which is not only related to foreign exchange risks. This document does not specifically deal with other applications of financial instruments, as the issue of financial instruments is still under debate and is seen as a separate discussion area. However, the principles set out may under certain circumstances apply accordingly.

DEFINITIONS

6. The following terms are used in this document with the meanings specified:

Reporting currency is the currency used in presenting annual or consolidated accounts.

Foreign currency is a currency other than the reporting currency of an enterprise.

Parent is defined by Article 1 of the Seventh Directive.

Foreign operation is a subsidiary, associated company, joint venture or branch, whose activities are based or substantially conducted in a currency other than the currency of the reporting enterprise.

Net investment in a non-integrated foreign operation is the reporting enterprise's equity share in the net assets (capital and reserves representing the residual ownership of all the assets of an enterprise after the liabilities and other preferred claims have been satisfied) of that entity.

Translation is the process of expressing in the reporting currency of the enterprise those amounts that are denominated or measured in a foreign currency. It includes both the expression of individual transactions in terms of the reporting currency and the expression of a complete set of annual accounts drawn up in a foreign currency in terms of the reporting currency.

Translation differences result from translation as defined above at different times at different rates. It is the difference between the book value expressed in the

reporting currency before recalculation and the value expressed in the reporting currency after recalculation at the new rate.

Negative translation difference is a translation difference which has an adverse effect on the net assets of the enterprise.

Positive translation difference is a translation difference which has a favourable effect on the net assets of the enterprise.

Exchange rate is the ratio for exchange of two currencies.

Spot rate is the exchange rate on a particular day for the exchange of two currencies on that date. [1]

Forward rate is the exchange rate established under the terms of an agreement for the exchange of two currencies at a specified future date.

Closing rate is the spot rate that exists at the balance sheet date.

Historical rate is the spot rate at which foreign currency could be exchanged at the date a specific transaction or event occurred.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money. All other assets and liabilities are non-monetary items. A detailed specification based on the balance sheet lay-out as prescribed by the Fourth Directive is attached in the annex.

Foreign currency loan is a loan denominated in a foreign currency, regardless of the currency, or form, in which the loan was received.

Settlement date is the date at which a debt is collected or a creditor is paid.

Long-term liabilities are those liabilities becoming due and payable after more than one year from the balance sheet date.

Long-term assets are those assets not expected to be realised within one year from the balance sheet date.

Freely tradeable currency is a currency which can be exchanged into another currency without restriction. Restrictions may for example be created by government or originate from the economic position of the country or the malfunctioning of the market for this currency.

Temporal method [2] is the method of translation under which assets and liabilities (as well as income items derived from them) are translated at the spot rates applicable on the dates as at which the carrying amounts of the assets and liabilities were established. Fixed assets and related depreciation, stocks and related costs of

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1 In banking practice, the actual delivery may take place one or two days later.

2 In some countries the interpretation of the temporal method also includes the assessment for particular assets and liabilities as to whether the value at balance sheet date translated at the closing rate would result in an unrealised loss. If not, then the historical exchange rate is used. This applies in particular to debtors, creditors and liquid assets (other than cash and bank deposits) in foreign currencies. In some countries, it also applies to fixed assets and stocks which can only be repurchased in a particular foreign currency or can only be utilised in a particular foreign country.

sales and other non-monetary items are translated into the reporting currency at exchange rates ruling at the dates of acquisition or latest revaluation of such assets. All other balance sheet items except for capital and reserves (i.e. monetary items) are translated at the closing rate. All other items of the profit and loss account are translated at spot rates existing at the time of the transaction. For practical purposes an average rate for the period may be used. Translation of the figures for profit or loss and capital and reserves are not relevant, as these are balancing amounts affected by the translation process.

Closing rate method is a method of translation under which all items in the annual accounts are translated into the reporting currency at the closing rate. Translation differences are taken to either income or capital and reserves.

Closing rate/Net investment method is a method of translation under which all items in the balance sheet of a non-integrated foreign operation are viewed as a whole and included in the consolidated accounts by translation at the closing rate. Items of the profit and loss account are translated at either closing rates or rates existing at the time of the transaction. In the latter case, for practical purposes an average rate for the period may be used. Translating the balance sheet at closing rate implicitly results in the translation of the result at closing rate. The resulting difference between translating the net profit or loss for the period at average rate in the profit and loss account and at the closing rate in the balance sheet is taken to capital and reserves.[3] The translation difference that results from translating the opening and closing balance sheets at different exchange rates is transferred directly to the group's capital and reserves.

Annual accounts are defined in Article 2 of the Fourth Directive. Consolidated accounts are defined in Article 16 of the Seventh Directive.

EXPLANATION

7. A reporting entity may carry on activities in a foreign currency in two ways:

   (a) It may have transactions in foreign currencies which are unsettled at year-end and lead to foreign currency monetary items in the annual accounts. Foreign currency monetary items must be expressed in the reporting currency of the entity in order to prepare its annual accounts.

   (b) It may have foreign operations. In order to prepare the annual or consolidated accounts of the reporting enterprise in its reporting currency, foreign currency annual accounts of such operations must be translated.

ANNUAL ACCOUNTS

Translation of foreign currency monetary items in annual accounts

Exchange rate used

8. At the balance sheet date, foreign currency monetary items that result from unsettled transactions in foreign currency might be translated at the closing rate or at the historical rate. Combinations might also be possible: for example, one might adopt a different view concerning the exchange rate to be applied according to whether the result would be a positive or negative translation difference, or

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[3] In some countries this difference is taken to "Other operating income or charges" in the profit and loss account

depending on the nature of the item (long term or short term). A reason for translating certain items at historical rates may be that in a period of fluctuating exchange rates one should not account for any translation difference before the transaction is settled, except in those cases where using the closing rate would result in a negative translation difference. Others believe that, notwithstanding that exchange rates may fluctuate in the future, stating the foreign monetary item at the current equivalent amount in the reporting currency provides a more useful presentation of the financial position of the enterprise at the balance sheet date. Consequently, all differences between the amount presented in the current annual accounts and the amount at which the transaction was recorded during the period or at which it was presented in previous annual accounts are regarded as gains or losses.

Although the closing rate is easily determinable for freely tradeable currencies, a problem might arise in determining the closing rate for non-freely tradeable currencies, since no market exists to provide such an exchange rate.

Set-off of translation differences

9. Article 7 of the Fourth Directive states that any set-off between asset and liability items, or between income and expenditure, shall be prohibited. Furthermore Article 31.1.e. requires that the components of asset and liability items be valued separately. The application of these principles causes a particular problem where the balance sheet contains foreign currency monetary items. The separate valuation of asset and liability items may result in nothing more than arithmetic differences.

   One has to consider the consequences for income determination of the method used. The prudence principle applies: the method should not result in the transfer of risks and negative translation differences of the current period to future periods. But, when on the asset side of the balance sheet a debtor is denominated in a freely convertible foreign currency and on the liability side a creditor in the same currency, for the same amount (including any write-off for bad debts) and with the same due date, it is clear that there is no foreign currency risk whatsoever for the enterprise involved. It is therefore always possible to set-off to a certain extent, not the items on the balance sheet themselves, but the resulting translation differences.

   One can go one step further when there are various items with different amounts, if they are denominated in the same currency and have the same due date. In this case, only the translation difference after set-off is meaningful.

10. The question arises whether set-off would also be possible when the maturities of the asset and liability items involved are approximately but not exactly, the same. A possible approach would be to classify foreign currency items (including relevant off-balance sheet items) by maturity and to aggregate and treat as short-term those which will be converted into the reporting currency in the near future. The discussion should therefore focus on the recognition of the translation difference on the short-term foreign currency position in the profit and loss account. One of the reasons put forward in support of this is the fact that the profit and loss account should provide an insight into the performance of management with regard to foreign currency risk. The question then remains whether a maximum period for the definition of short term should be specified. In principle, the maximum period should reflect the business cycle of an enterprise. This period would normally be not more than one year, although there might be exceptions. Should it be found desirable to define a term, the period should not normally exceed one year. In any event the enterprise should disclose in the notes this maximum period as part of the accounting policies. Such an obligation would require an initial assessment of the measurement and management of foreign exchange risk. However, some argue that where the exchange rate between the foreign currency and the reporting currency is volatile, the set-off of positive and negative differences, even short-term, should not be allowed because of the risks involved.

Items not falling within the short-term foreign currency position would be classified separately, and could be subject to a different accounting treatment. However, some are of the opinion that because liquid long term markets exist, translation differences on long term items should be treated in the same way as on short term items.

11. Another question relates to whether translation differences arising from items denominated in different but linked foreign currencies can be off-set. Some people argue that foreign currency positions should not be off-set on an individual basis but rather on a collective basis in the case of exchange rate systems (arrangements whereby a group of countries agrees to maintain the exchange rate fluctuations between their currencies within prefixed margins, or the voluntary linkage by a country of its currency to another currency). Some go even further and defend the netting of all positive and negative differences on freely tradeable currencies. Both approaches are based on the fact that in modern financial markets every position in a freely tradeable currency can be transformed into a position in any other freely tradeable currency: therefore it is no longer necessary to look at individual items expressed in foreign currencies. Others argue that the set-off of translation differences on items denominated in currencies which are not linked may conflict with the principle described in Articles 7 and 31.1.e of the Fourth Directive.

12. In view of the reasoning above and in order to establish a minimum degree of comparability it would seem appropriate to set-off all translation differences on short-term items.

Treatment of net translation differences on long and short term items

13. Whereas there is agreement that negative translation differences should be charged against income, different treatments of positive translation differences exist within the Community. The principal treatments are:

    a) Positive translation differences that remain after netting against negative differences are not recognised. The respective monetary items to which they relate continue to be valued at historical rates in the balance sheet.

    b) Positive translation differences that remain after netting against negative differences are deferred under a separate heading in the balance sheet.[4]

    c) Positive translation differences that remain after netting against negative differences are included in the profit and loss account.

    In some Member States some or all positive translation differences are not netted against negative translation differences. The impact of netting is addressed in paragraphs 9 to 12.

14. In the case of any positive translation difference, there is a potential conflict between the prudence principle, including the concept of realisation of profits, and the accruals principle. Member States which do not allow positive differences to be included in income (treatments a) and b)) base their argument on the grounds that such amounts are unrealised profits which, given Article 31.1.c.(aa) of the Fourth Directive, cannot

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[4] In some Member States the deferred amount is not necessarily the total amount of positive translation differences that remain after netting.

For long term items, method b) can be applied in two ways: In some countries the deferred balance is amortised over the remaining life of the monetary items; in some other countries the deferred balance is maintained until realised or compensated by future negative translation differences.

be included in income. In contrast, those Member States which accept that positive differences should be included in income (treatment c)), do so on the basis that the positive translation differences are immediately realisable in the normal situation of a liquid market and therefore cannot be considered as unrealised profits. Not recognising them in income would give insufficient weight to the accruals principle (Article 31.1.d of the Fourth Directive).

15. The reasons for applying treatment a), not recognising positive translation differences, are generally based on a certain interpretation of the prudence principle (paragraph 14). The basic idea of the prudence principle is that unrealised gains and losses cannot be treated in the same way. Moreover, if one would define profits which could be realised on the market but which are not yet realised by the enterprise as realised in the sense of Art. 31.1.c.(aa). of the Fourth Directive (treatment c)), this would imply that similar profits on other assets (e.g., commodity stocks) must also be reflected in the balance sheet and in the profit and loss account. This, however, is regarded by some as being incompatible with the historical cost accounting principle of Art. 32 of the Fourth Directive. Of course, it is possible to depart from the general principles laid down in Article 31 (1) of the Fourth Directive (including the prudence principle), in exceptional cases (Article 31 (2)). Such departures can however only be decided upon in each individual case and it would be incorrect to regard foreign currency translation as a general exception from the principles laid down in Article 31 (1) of the Fourth Directive. The same applies to the true and fair view override (Article 2 (5) of the Fourth Directive). Here again, the derogation provided for in the Directive only applies to individual and exceptional cases.

16. Method b) can be considered as a combination of methods a) and c). Amongst the reasons for supporting method b), deferring positive translation differences, may be the following. Proponents of this treatment use partly the same arguments as mentioned in paragraph 15 stressing the prudence principle. An argument for method b) as opposed to method a) is that, unlike stocks, the realisable value of monetary items can easily be calculated. Therefore all monetary items must be translated at the closing rate. As a consequence the treatment provides more information about unrealised positive translation differences, as they are shown in the balance sheet. However, the usefulness of this information can be questioned, because the deferral consists of unrealised gains and off-set losses from different periods which cannot be allocated to a particular period.

17. One of the reasons for applying treatment c), recognising both positive and negative translation differences in income, is that a symmetrical treatment of profits and losses is required in order to facilitate a fair measurement of the performance of the enterprise, in relation to the management of economic exposure resulting from foreign currency risk. Moreover, making the distinction between realised and unrealised positive translation differences, as required under treatment a) and b), is arbitrary, as for instance open positions in foreign currencies are realisable in the market, so that unrealised gains could, without much effort, be turned in realised gains at the balance sheet date. Furthermore, an event such as an exchange rate change cannot be ignored in measuring monetary items at a balance sheet date since the amounts payable or receivable are no longer the same in terms of the currency in which the annual accounts are measured. Thus foreign exchange closing rates must be used. This implies that changes after the balance sheet date are events that take effect in the next financial year. Therefore some consider that not recognising the positive translation

differences whilst recognising the negative translation differences would be illogical (because it denies in effect that any favourable movement in the exchange rate had occurred). It would therefore also inhibit fair measurement of the performance of the enterprise in the year.

Some supporters of treatment c) would require in addition that a provision should be set up to the extent that realisation of the positive differences on those currencies that are not freely tradeable appears uncertain. However, a provision could only be justified in the context of future potential losses.

18. Some are of the opinion that the translation differences on long term monetary items should be deferred and amortised on a systematic basis over the remaining life of the monetary items to which they relate. However, users of annual accounts should be informed of the results of an exchange rate change in the period of change rather than at a later settlement date, which might be many years after the exchange rate change. Methods involving amortisation of translation differences fail to recognise the full effects of exchange rate changes in the period of the exchange rate change. Moreover, translation losses must be recognised immediately in the profit and loss account.

Comparability or not ?

19. From the discussion in paragraphs 13 to 18 it appears that there are major differences in views on the accounting treatment of foreign currency translation differences. If no further guidance is given, comparability will not be improved. There are several ways to improve comparability: (1) prescribing one method, (2) introducing one method as the benchmark method, or (3) not choosing one particular method but requiring reconciliation information to be disclosed in the notes to the accounts, allowing the reader to reconcile from one method to the others and vice versa. Given the differences in points of view outlined above, the first alternative does not seem practicable. The other two alternatives are elaborated upon in the following two paragraphs.

20. If the third alternative (disclosure of reconciliation information to each of the other methods) were chosen, this would lead to an extensive list of disclosures to be provided by every company in each country. It is questionable whether such extensive disclosure would be practicable, bearing in mind that it serves no further information purposes. For example, the reconciliation to method b) would be quite difficult given the problems indicated in paragraph 16.

21. If one wished to introduce as a benchmark method one of the treatments described in paragraph 13, consideration should be given to the merits, per se, of each of the available methods.

A reason for preferring method c) as the benchmark, at least for short-term items, would be that the translation difference on the short term freely tradeable (or linked) foreign currency position gives, in principle, the best evaluation possible of the exchange gain or loss on short term operations. Given that it relates to events in the current year, it seems necessary to account for it in the profit and loss account, regardless of whether it is positive or negative. Justification for the recognition of all translation differences on short term items lays in the negotiability of the relevant

currency and the existence of a liquid market, allowing transactions at any time in each currency.

Because it is possible to hedge a position, leading to the set-off of a translation difference by an opposite translation difference, the absence of a hedge is a deliberate exposure to foreign currency risk of which the consequences should be treated symmetrically in order to reflect economic substance.

In some Member States the application of method c) might be hampered by legal and/or fiscal problems.

Short term items

If one wishes to introduce a benchmark for the treatment of translation differences on short-term items, it is suggested that method c) be chosen as the benchmark method - recognising all positive and negative translation differences in the profit and loss account. If method a) or b) were applied, additional disclosure enabling the user to reconcile to method c) as suggested in paragraph 38 may be necessary.

Long term items

Taking into account the complex problems involved in reconciling to method b), the use of either method c) - recognising all positive and negative translation differences in the profit and loss account - or method a) - recognising only unrealised negative translation differences - for long-term items is suggested. Comparability in both directions would be ensured by additional disclosure in the notes to the accounts (paragraph 38).

Other aspects

22. As stated in paragraph 5 this document does not deal with the particular characteristics of financial instruments. However, in as far as foreign currency risk arises from off-balance sheet items, such a risk having an adverse effect on the net assets should be recognised by the setting up of a provision in the balance sheet.

23. It is common practice, in the case of a hedged position of foreign currency items, to use the exchange rate specified in the hedging instrument as the basis for translation and to defer any resulting translation difference until the expiry of the position.

    The interest element, being the difference between the forward rate and the spot rate (at the inception of the hedging instrument) should be recognised as interest income or expense over the life of the hedging instrument.

24. Some long term monetary items may in substance represent an extension or reduction of the reporting enterprise's net investment in a non-integrated foreign operation. In this case the translation of these monetary items should follow the treatment applied for that particular net investment.

25. If a long term foreign currency debt is contracted so as to finance or cover a capital investment in a foreign undertaking (and is effective as a hedge) the company may be covered in economic terms against any movement in exchange rates. It would be inappropriate in such cases to record an accounting profit or loss when exchange rates

change. In as far as such investment is valued at historical cost, and therefore translated at historical rate, the debt would also be translated at historical rate. Alternatively, both would be translated at closing rate. In as far as such investment is valued at the lower market value the investment and the related long term foreign currency debt would be translated at the closing rate.

If the equity method is used to account for investments, the long term foreign currency debt would also be translated at the closing rate. The resulting translation difference would normally be taken to reserves without passing through the profit and loss account, as changes in the equity value resulting from changes in the exchange rate of the related asset are usually directly included in reserves. If the foreign undertaking is located in a country suffering from high inflation, paragraph 37 should be applied before translation of the net equity of the foreign undertaking.

Incorporation of integrated foreign branches into the annual accounts

26. One of the characteristics of a branch is that it does not possess a separate legal identity. Consequently, in a large number of Member States, the inclusion of the accounts of a branch in those of the undertaking is performed on the basis that the branch is not economically independent and that its operations are an integral part of the operations of the reporting enterprise. In such a case, the elements of the branch denominated in a foreign currency are translated as elements of the undertaking, i.e. by using the temporal method, and the differences treated according to treatment a), b) or c) as described in paragraph 13. The essence of the application of the temporal method is that no distinction is made between the main enterprise and the foreign branch.

    In Member States where different translation methods may be adopted depending on the economic relationship between the branch and the undertaking, the temporal method should only be used for integrated branches. The criteria for distinguishing integrated (dependent) from non-integrated (independent) operations are set out below in paragraph 28. Non-integrated branches are dealt with by paragraphs 30 to 36.

CONSOLIDATED ACCOUNTS

27. Whereas for the annual accounts the problems of agreeing on one foreign currency translation method are considerable, because of differences in points of view as to the purpose of the annual accounts (capital maintenance versus performance measurement) and on the use of annual accounts for taxation purposes, these problems are of less importance for consolidated accounts, because consolidated accounts are normally not subject to the constraints resulting from capital maintenance (e.g. profit distribution purposes) and taxation requirements. For this reason one single method is recommended for the recognition of translation differences in the annual accounts to be incorporated in consolidated accounts, as well as for the translation of annual accounts expressed in foreign currency. Article 26 of the Seventh Directive requires that consolidated accounts shall show the assets and liabilities, financial position and profits or losses of the undertakings included in the consolidation as if the latter were a single undertaking. This means inter alia that uniform methods should be applied (Article 29.(1)) for accounting for translation differences in the annual accounts for

consolidation purposes. This may lead annual accounts for consolidation purposes to differ from the statutory annual accounts.

The use of one single method for the recognition of translation differences in the annual accounts to be incorporated in consolidated accounts in the European Community may imply for parent undertakings in some Member States that the method used in the consolidated accounts differs from the method used in the statutory annual accounts. Article 29.(2) of the Seventh Directive provides an option to Member States to require or permit the use in the consolidated accounts of valuation methods other than those used in the annual accounts of the parent undertaking. This would leave open the possibility of introducing one single method for the treatment of translation differences. The single method should then be applied both for the annual accounts of the parent undertaking as included in the consolidation as well as for the annual accounts of the subsidiaries included in the consolidation. It is suggested that for these purposes both positive and negative translation differences be included in the profit and loss account. Where Member States have not made full use of the option in Article 29.(2) and parent undertakings cannot use the method suggested above, this should be disclosed.

Below, the various of methods of including these unified annual accounts expressed in foreign currencies in the consolidated accounts are discussed.

28. There is considerable variation in the operating relationships between parents and their foreign operations which influences the way in which they are incorporated into the consolidated accounts. A distinction is made between integrated operations and non-integrated operations, which are each treated differently.

    Whether a foreign operation should be regarded as integrated or as non-integrated depends on the particular circumstances. This should be determined on an individual basis which may lead to the situation where one subsidiary is treated differently from another because the former is integrated and the latter is not. Whether the currency of the reporting enterprise is the dominant currency in the economic environment in which the foreign operation conducts its activities is a significant factor in determining its status. Matters to be taken into account include:

    (a) Are labour, materials and other costs of the foreign operation's products primarily local costs or does the foreign operation depend on products and services obtained primarily from the country in which the parent is located ?

    (b) Is there little interrelationship between the day to day activities of the foreign operation and those of the parent, or do intercompany transactions with the parent represent a high proportion of the foreign operation's day to day activities ?

    (c) Are the day to day activities of the foreign operation financed mainly from its own operations and local borrowings or are they mainly dependent on finance provided by the parent ?

    (d) Is the foreign operation's market mainly outside the parent's country or within it ?

(e) Is there any other factor that would indicate that the cash flows of the parent are insulated from, or, conversely, are directly affected by, the day to day activities of the foreign operation ?

Examples of situations where an undertaking is considered to be integrated are where it is:

(a) acting as a selling agency receiving stocks of goods from the parent company and remitting the proceeds back to the company;

(b) producing a raw material or manufacturing parts or sub-assemblies which are then shipped to the parent company for inclusion in its own products;

(c) located overseas for tax, exchange control or similar reasons to act as a means of raising finance for other companies in the group.

Translation of annual accounts of integrated foreign operations

29. The situation for an integrated subsidiary, where its day-to-day transactions have a direct impact on the operating results and cash flow of the parent, is the same as described for an integrated branch. As the activities of the dependent subsidiary are seen to form part of the activities of the parent, the annual accounts of the foreign subsidiary would be translated into the reporting currency by using the temporal method. The resulting positive and negative translation differences would be included in the profit and loss account, as described in paragraph 25.

Translation of annual accounts of non-integrated foreign operations

30. The method of translating the annual accounts of foreign operations is determined by an assessment of the operational and financial characteristics of those operations. Various methods are currently in use for translating the annual accounts of foreign operations:

a) temporal method

b) closing rate method

c) closing rate/net investment approach

31. The effect of the temporal method is to treat the transactions and foreign exchange exposures of all the foreign operations as though they were those of the parent. A single basis of measurement - the parent's currency - is used for all items in the consolidated accounts, that is, all foreign currency exposures are measured against that currency. All exchange differences arising under the method are taken to the profit and loss account. The method has a consistent rationale which can apply as well to current cost accounting as to the historical cost convention.

A weakness of the temporal method is that it makes no distinction between foreign operations that are integrated and those that are not. The method is clearly suitable for translating the accounts of integrated operations, since it is the same method as is applied to the accounts of the parent with which they are integrated. However, when the method is applied in translating the accounts of foreign operations, it changes the financial results and relationships of those operations by re-measuring them in terms

of the parent's currency (in particular stocks and fixed assets are translated at historical rates and debt at current rates). The differences arising on such re-measurement may be considerable, since they do not correspond with economic exposures experienced within the foreign operations themselves and, therefore, cannot reasonably be hedged by foreign currency transactions. Since the differences are taken to the profit and loss account, they can result in significant volatility in reported earnings.

32. The closing rate method takes many forms but, except in the closing rate/net investment approach (see below), it, too, does not distinguish between foreign operations that are integrated and those that are not. In consequence, exchange differences that represent a real gain or loss to foreign operations within the group are not necessarily reflected in the consolidated accounts.

33. The essence of the closing rate/net investment approach is that the translation process is undertaken in two stages. The first stage is the translation, in the annual accounts for consolidation purposes of the local entity, of individual foreign currency items into the local currency of the entity, whereby translation differences are included in the net income of the local entity or, in as far as positive differences are concerned, are deferred or not accounted for as described in paragraph 13. The second stage is the translation of the balance sheets into the reporting currency using closing rates. The items of the profit and loss accounts are translated at either the closing rates or at rates existing at the time of the transactions. The translation differences that are the effect of changes of the exchange rate from one year-end to another are taken directly to reserves because a change in the exchange rate has little or no direct effect on the activities or present and future cash flows from operations of either the parent or the foreign operation and as such inclusion of such differences would distort the profit and loss account.

    An important advantage of the net investment/closing rate method is that is preserves the financial results and relationships of the underlying businesses included in the consolidated accounts. Since the foreign activities are conducted in a foreign environment and future cash flows will be in a foreign currency, it is that currency rather than the reporting currency of the parent that must be the basis for measuring the exchange rate gains and losses of the foreign operation to be taken to the consolidated profit and loss account. The parent's investment in its foreign operation does give rise to an exchange rate difference but one that is of an entirely different kind from the gains and losses stemming from the foreign operation's own accounts, since it has no direct implications for future cash flows. This difference arises on the business as a whole (the net investment) rather than from the individual assets and liabilities of the foreign operation. Some believe that the closing rate/net investment approach is incompatible with the principle that consolidated accounts should present the aggregated results of a group of undertakings as if they were those of a single undertaking. Others believe that the closing rate/net investment approach supports rather than conflicts with the principle of consolidation since it aims to reflect in the consolidated accounts the economic reality of the transactions of the foreign operations. The closing rate/net investment approach is often used in Europe, because of experience of having substantial operations in several fluctuating currencies. It is also argued that the temporal method is best suited to those situations where most of the group's operating activities is conducted in one currency.

Suggested method of translation in consolidated accounts

34. Taking into account the considerations discussed above, for non-integrated foreign operations preference is given to the closing rate/net investment approach. Annual accounts of integrated foreign operations should be incorporated in the consolidated accounts by means of the temporal method (as described in paragraph 27).

35. The application of the temporal method in the first stage of the closing rate/net investment approach leaves open the possibility of a different treatment of positive translation differences, as described in paragraph 13. This would distort the application of the closing rate/net investment method. However, Article 29 of the Seventh Directive provides that for drawing up consolidated accounts, undertakings do not necessarily have to follow the same approach adopted for the annual accounts, as discussed in paragraph 27. Therefore it is suggested that, in order to achieve comparability of information and to increase harmonisation, in preparing consolidated accounts, the temporal method be used in the first stage of the closing rate/net investment approach, recognising all translation differences, whether positive or negative, in income, thus including them in the profit and loss account. Although some argue that the recognition of all translation differences is not in accordance with Article 31 of the Fourth Directive, this does not mean that it is the only point of view. The parent undertaking in preparation of its annual accounts for consolidation purposes should use the same temporal method, recognising all translation differences, whether positive or negative, in income, thus including them in the profit and loss account in order to be consistent based on Article 29 of the Seventh Directive as discussed above. The parent undertaking will be allowed to apply a different treatment of translation differences compared to its annual accounts.

36. Translation differences arising on reporting an entity's long term foreign currency monetary items would also be accounted for by recognising all positive and negative translation differences in the profit and loss account. However, in the following cases specific methods would be applied.

    a) To the extent that an intra-group monetary item in fact represents a part of the net investment of a parent undertaking in a foreign operation, translation differences arising on the elimination of intra-group balances would, when the net investment method is used, be taken to reserves in the consolidated accounts.

    b) To the extent that translation differences arise from long term foreign currency debt contracted so as to finance or cover a capital investment in a foreign undertaking (and effective for that purpose), they would be taken to reserves in the consolidated accounts.

Translation of annual accounts of entities affected by a high inflation rate

37. When an entity has activities in countries suffering from high inflation it is necessary, whenever possible, to adjust the local accounts for the effects of inflation on the results before translating at year end rates in order that the translated amounts give a true and fair view of the assets and liabilities, financial positions and profits or losses of the foreign activities.

DISCLOSURE

38. Annual accounts should give the following disclosures:

    a) -Description of the methods of translating the items in the balance sheet and profit and loss account expressed in foreign currencies.

       - Description of the treatment of positive and negative translation differences and the policy for the netting of differences (including whether a distinction is made between long term and short term items, and whether and when translation differences on items in the various currencies are off-set).

    b) The amount of foreign currency gains and losses included in the profit and loss account showing separately gains and losses on short-term items and gains and losses on long-term items.

    c) The net translation difference for the period taken to the reserves as a result of applying procedures in paragraph 25.

39. If a benchmark is chosen, then the following additional disclosures should be made:

    a) For translation differences on short-term items where method c) (paragraph 13) has not been applied, the amount of net unrealised positive and negative translation differences <u>not</u> included in the profit and loss account.

    b) For translation differences on long-term items:

       -where method a) (paragraph 13) is applied, the amount of unrealised positive translation differences not included in the profit and loss account.

       -where method c) (paragraph 13) is applied, the amount of unrealised positive translation differences included in the profit and loss account.

40. The following disclosures should be made with regard to the translation of the annual accounts of foreign operations for incorporation in the consolidated accounts of a reporting enterprise:

    a) - Description of the methods used for the translation of the annual accounts of foreign operations for incorporation in the consolidated accounts.

       - Description of the treatment of positive and negative translation differences and the policy for the netting of differences (including whether a difference is made between long term and short term items, and whether and when translation differences on items in the various currencies are off-set).

    b) The amount of foreign currency gains and losses included in the profit and loss account showing separately gains and losses on short term items and gains and losses on long-term items.

    c) The difference arising on the translation of the net investment for the period taken to reserves as a result of applying the procedures in paragraphs 33 to 36.

ANNEX I

	Monetary	Non-monetary
Assets		
A. **Subscribed capital unpaid**		X 1)
of which there has been called	X	
unless national provides that called-up capital be shown under 'liabilities'. In that case, the part of the capital called but not yet maid must appear as an asset either under A or under D (II) (D)		
B. Formation expenses		X
as defined by national law, and in so far as national law permits their being shown as an asset. National law may also provide for formation expenses to be shown as the first item under 'Intangible assets"		
C. Fixed Assets		
I. Intangible assets		
1. Costs of research and development, in so far as national law permits their being shown as assets..		X
2. Concessions, patents, licenses, trademarks and similar rights and assets, if they were :		X
a) acquired for valuable consideration and need not be shown under C (I) (3); or		
b) created by the undertaking itself, in so far as national law permits their being shown as assets..		
3. Goodwill, to the extent that it was acquired for valuable consideration.		X
4. Payments on accounts	X 2)	
II. Tangible assets		
1. land and buildings		X
2. Plant and machinery		X
3. Other fixtures and fittings, tools and equipment		X
4. Payments on account and	X 2)	
tangible assets in course of construction		X
III. Financial assets		
1. Shares in affiliated undertakings		X
2. Loans to affiliated undertakings	X	
3. Participating interests		X
4. Loans to undertakings with which the company is linked by virtue of participating interests	X	
5. Investments held as fixed assets	X 3)	X 3)
6. Other loans	X	
7. Own shares (with and indication of their nominal value or, in the absence of an nominal value, their accounting par value) to the extent that national law permits their being shown in the balance sheet		X 4)

	Monetary	Non-monetary
D. Current assets		
I. Stocks		
1. Raw materials and consumable		X
2. Work in progress		X
3. Finished goods and goods for resale		X
4. Payments on account	X 2)	
II. Debtors (Amounts becoming due and payable after more than one year must be shown separately for each item).		
1. Trade debtors	X	
2. Amounts owed by affiliated undertakings	X	
3. Amounts owned by undertakings with which the company is linked by virtue of participating interests	X	
4. Other debtors	X	
5. Subscribed capital called but not paid (unless national law provides that called-up capital be shown as an asset under A)	X 1)	
6. Prepayments and accrued income (unless national law provides for such items to be shown as an asset under E)	X 5)	
III. Investments		
1. Shares in affiliated undertakings		X 7)
2. Own shares (with an indication of their nominal value or, in the absence of a nominal value, their accounting par value) to the extent that national law permits their being shown in the balance sheet	X 1)	X 1)
3 Other investments		X
IV. Cash at bank and in hand	X	
E. Prepayments and accrued income	X 5)	
(unless national law provides for such items to be shown as an asset under D (II) (6))		
F. Loss for the financial year		X
(unless national law provides for it to be shown under A (VI) under 'liabilities")		
Liabilities		
A. Capital and reserves		
I. Subscribed capital		X 1)
(unless national law provides for called-up to be shown under this item. In that case, the amounts of subscribed capital and paid-up capital must be shown separately)		
II. Share premium account		
III .Revaluation reserve		

	Monetary	Non-monetary
IV. Reserves		
1. Legal reserve, in so far as national law requires such a reserve		
2. Reserve for own shares, in so far as national law requires such a reserve, without prejudice to Article 22 (1) (b) of Directive 77/91/EEC.		
3. Reserves provided for by the articles of association		
4. Other reserves		
V. Profit or loss brought forward		
VI. Profit or loss brought forward		
(unless national law requires that this item be shown under F under "Assets" or under E under "Liabilities")		
B. Provisions for liabilities and charges		
1. Provisions for pensions and similar obligations	X	
2. Provisions for taxation	X	
3. Other provisions	X 6)	X 6)
C. Creditors		
(amounts becoming due and payable within one year and amounts becoming due and payable after more than one year must be shown separately for each item and for the aggregate of these items).		
1. Debenture loans, showing convertible loans separately	X	
2. Amounts owed to credit institutions	X	
3. Payments received on account of orders in so far as they are not shown separately as deductions from stocks	X 2)	
4. Trade creditors	X	
5. Bills of exchange payable	X	
6. Amounts owed to affiliated undertakings	X	
7. Amounts owed to undertakings with which the company is linked by virtue of participating interests	X	
8. Other creditors including tax and social security	X	
9. Accruals and deferred income (unless national law provides for such items to be shown under D under "Liabilities")	X 5)	
D. Accruals and deferred income	X 5)	
(unless national law provides for such items to be shown under C(9) under "Liabilities")		
E. Profit for the financial year		X
(unless national law provides for it to be shown under A (VI) under "Liabilities"		

Footnotes:

1) The subscribed capital unpaid may be seen as a monetary position in so far as it is called up. Translation of the figures for profit or loss and capital and reserves is not relevant, as these are the balancing amounts affected by the translation process.

2) Payments on account and payments received on account on the one hand may be seen as debtors and creditors, that is as monetary positions. On the other hand in practice they are often not shown in a separate position but deducted from provisions (prepayments) or from stock (prepaid creditors). The last case is mentioned in Art. 9 c 3 of the Fourth Directive. Perhaps it is more reasonable to translate those payments which are deducted in the same way as the positions from which they are deducted. If these are not monetary positions a classification of payments on account and payments received on account may cause contradictions.

3) These positions contain monetary items in so far as the investments are debtors.

4) The additional information of nominal value is a monetary position.

5) The accruals and deferred income positions contain monetary items in so far as they can be regarded in economic terms as debtors and creditors.

6) The provisions contain monetary items in so far as they can be regarded in economic terms as creditors. The nature of the provisions is determined by the nature of the items provided against.

7) Shares in affiliated undertakings are in the main text referred to as foreign operations.

ANNEX II

LEGAL AND OTHER REQUIREMENTS ON FOREIGN CURRENCY TRANSLATION

1. Legal accounting and disclosure requirements on foreign currency translation

Accounting and disclosures requirements on foreign currency translation are **not** specifically addressed by the law in the following countries:

- Denmark

- Germany

- Ireland

- Italy

- Luxembourg

- Netherlands

- United Kingdom

However, it should be noted that in the above countries the legislation includes a requirement based on Article 43.1.(1) of the Fourth Directive. This article states that:

"1.In addition to the information required under other provisions of this Directive, the notes on the accounts must set out information in respect of the following matters at least:

(1) the valuation methods applied to the various items in the annual accounts, and the methods employed in calculating the value adjustments. For items included in the annual accounts which are or were originally expressed in foreign currency, the bases of conversion used to express them in local currency must be disclosed."

Germany

Despite the fact that German law contains no requirements other than those referred to above it is a generally accepted accounting principle to consider foreign currency translation as part of the evaluation. From this situation, legal restrictions with respect to the applicability of various translation methods can be derived since these must comply with the requirements of the Commercial Code:

Amounts in foreign currency are valued on the basis of historical costs (§ 253, 1 HGB). All anticipated risks and losses which arise up to the balance sheet date shall be taken even if they only become known after the balance sheet date but prior to the date of preparation of the financial statements.

Profits may only be recognised if they are realised at the balance sheet date. The prudence concept (§ 252, 1 no. 4 HGB) requires that unrealised losses have to be accrued but forbids recognition of unrealised profits.

As regards consolidated financial statements, there is no uniform requirement: Foreign currency translation may for the purposes of consolidated accounts be considered either as an evaluation measure or as a translation procedure, thus expanding the range of permissible differing translation methods.

With respect to credit institutions, § 340 h of the Commercial Code contains detailed requirements. These provisions, however, are not to be used as a basis for the preparation of accounts generally since they are part of the law which is exclusively devoted to credit institutions. § 340 h HGB was introduced into German law with the implementation of the EC Bank Accounts Directive.

Luxembourg

The law provides that the annual accounts have to be stated on the basis of the principle of prudence and in particular that only profits realised at the balance sheet date may be included therein (Art. 235 (1) c) of the commercial law).

Italy

In Italy, the Company Law does not contain any legal requirements for foreign currency translation. But, the Tax Law has introduced procedures relating to the deductibility of exchange differences arising from translation of foreign currency monetary items when the closing rate is different from the rate at which they were recorded during the period or presented in previous financial statements (art. 72 of Income Law 917/1986).

According to this law, the provision for an exchange difference is accrued in a specified fund and is recognised in income within the limit of exchange differences arising on the setting-off of credits against debts in foreign currency translated at the closing rate of the last month of the exercise. The official closing rate is published by the Minister of Finance. When the difference arising on translation at the closing rate of all foreign currency monetary items in the financial statements is negative in respect of the amount recorded in the specified fund, it is deductible. Conversely, if, after the setting-off, the difference is positive the excess in respect of the specified fund is recognised in income for the period.

The exchange difference arising on settlement of monetary items must be covered by the a/m funds up to the total amount existing on the opening balance; further negative exchange differences are recognised in income for the period in which they are realised.

A distinction is made between translation differences arising on long term and short term foreign currency monetary items. The same treatment is considered for monetary items relating to affiliated companies. A distinction is also made between integrated (dependent) and non-integrated (independent) foreign branches and subsidiaries.

Disclosure is required of the methods used in accounting for foreign currency monetary items existing at the closing date.

United Kingdom

Despite the fact that the law contains no specific requirements on foreign currency translation other than those referred to above paragraph 12 of Schedule 4 to the Companies Act 1985 ("the Schedule") requires that the amount of any item shall be determined on a prudent basis and, in particular, that only profits realised at the balance sheet date shall be included in the profit and loss account. (Section 262(3) of the Companies Act 1985 defines realised profits in relation to a company's accounts as such profits of the company as fall to be treated as realised in accordance with principles generally accepted, at the time when the accounts are prepared, with respect to the determination for accounting purposes of realised profits.)

Paragraph 15 of the Schedule permits a departure from paragraph 12 of the Schedule if it appears to the directors that there are special reasons for such a departure. Particulars of any departure, the reasons for it and its effect must be given in a note to the accounts.

For companies other than exempt companies, all exchange gains taken through the profit and loss account, other than those arising on unsettled long-term monetary items, are realised. For such companies the application of paragraph 50 of SSAP 20 may result in unrealised exchange gains on unsettled long-term monetary items being taken to the profit and loss account. In SSAP 20 the need to show a true and fair view of results is considered to constitute a special reason for departure from the principle under paragraph 15 of the Schedule.

SSAP 20 is based on the assumption that the process of translation at closing rates for the purposes of SSAP 20 does not constitute a departure from the historical cost rules under Section C of the Schedule nor does it give rise to a diminution in value of an asset under Section B of the Schedule.

Paragraph 58 (1) of the Schedule requires that, where sums originally denominated in foreign currencies are brought into the balance sheet or profit and loss account, the basis on which those sums have been translated into sterling shall be stated.

Part I of the Schedule lays down the choice of formats permitted for the presentation of accounts. Distinction is drawn between operating and other income and expense. For this reason it is necessary to consider the nature of each foreign exchange gain or loss and to allocate each accordingly. Paragraph 68 of SSAP 20 states that "Gains or losses arising from trading transaction should normally be included under "Other operating income or expense" while those arising from arrangements which may be considered as financing should be disclosed separately as part of "Other interest receivable/payable and similar income/expense". Exchange gains or losses which arise from events which themselves fall to be treated as extraordinary items should be included as part of such items".

Paragraph 46 of the Schedule requires the following information to be disclosed about movements on any reserve or provision:

(a) the amount of the reserve or provision at the date of the beginning of the financial year and as at the balance sheet date respectively;

(b) any amounts transferred to or from the reserve or provision during that year; and

(c) the source and application respectively of any amounts so transferred.

Paragraph 60 of SSAP 20 requires the net movement on reserves arising from exchange differences to be disclosed.

The following gives a summary of the legal requirements in the countries in which foreign currency translation is addressed by law:

Belgium

<u>Annual accounts</u>:

The Royal Decree of 8 October 1976 on the annual accounts of enterprises only provides (article 36) for a disclosure requirement, as follows:

> "Methods and criteria used for expressing in BEF, assets, debts and liabilities denominated in foreign currencies, as well as methods for translation of financial statement of foreign branches, shall be disclosed in the notes under the valuation rules. Similar disclosure is required for the treatment of realised exchange differences and unrealised exchange differences on translation of foreign currencies in the annual accounts."

Consolidated accounts:

Article 42 of the Royal Decree of 6 March 1990 provides for a translation into BEF of assets and liabilities, rights and commitments, income and charges of the foreign subsidiaries included in the consolidation either according to the monetary/non-monetary method or according to the closing rate method. Other translation methods may apply in special circumstances.

The idea of the monetary/non-monetary method is described in article 43, § 1, paragraphs 1 and 2. When this method is applied, the translation differences have to be recognised in the income statement. They may, however, be treated according to the methods applied by the consolidating enterprise for the treatment of unrealised exchange differences in its annual accounts (see below).

The idea of the closing rate method is explained in article 43, § 1, paragraph 3. When this method is applied, a caption "Translation differences" on the liabilities side of the balance sheet is used in the cases described under article 43, § 2, 2.

Income and charges have to be translated at translation rates applicable at the dates when they were recognised; however, they may be translated at an average rate for interim periods or at an average rate for the financial period.

The notes to the consolidated accounts have to include the criteria governing the valuation of the various items in the consolidated accounts and, in particular, the bases of translation applied to express items which are, or which were originally, expressed in a currency other than the currency in which the consolidated accounts are stated and the translation in the consolidated accounts of the accounting statements of subsidiaries and associated enterprises governed by foreign law (art. 69, VI, b).

France

Accounting and disclosure requirements for foreign currency translation are laid down by the decree of 29 November 1983 for the annual accounts and by the decree of 17 February 1986 for the consolidated accounts. Specific provisions regarding both annual and consolidated accounts, are included in the "Plan Comptable Général (arrêté ministériel). Additional comments and recommendations are expected to be issued by the Conseil National de la Comptabilité (CNC).

1. Translation of transactions in foreign currencies

1.1. Annual accounts

In general all foreign currency monetary items are translated at the closing rate in the financial statements.

According to the plan comptable général (PCG):

A. CASH

Cash is translated on the basis of the closing rate. Any positive or negative translation difference is taken into income.

B. VALUATION OF RECEIVABLES AND LIABILITIES EXPRESSED IN FOREIGN CURRENCIES

Receivables and liabilities expressed in foreign currencies are translated and recorded in Francs on the basis of the closing rate. When the application of this translation rate at a year-end leads to changes in the amount of Francs originally recorded, the conversion differences are shown as suspense accounts (entitled "écart de conversion - passif" for positive differences or in case of negative translation differences "écart de conversion -

actif"). For tax purposes, both negative and positive translation differences are included in the corporate tax basis.

Unrealised gains are not recorded as profits. On the contrary unrealised losses cause the setting up of a provision for risks on the liability side of the balance sheet, the amount of which normally equals the unrealised translation loss recognised as an asset.

In the cases described below, where the setting-up of a provision does not give a true and fair view of the financial position and net income, the enterprise makes the necessary adjustments.

a) When the transaction in a foreign currency is hedged by the enterprise through a parallel operation intended to make up for the consequences of the exchange fluctuations, the provision is set up only to the extent of the unhedged risk.

b) When a foreign currency loan, on which an unrealised loss is observed, is dedicated to the acquisition of a fixed asset located in a country whose domestic currency is the same as that of the loan, or dedicated to the acquisition of securities representing these fixed assets, a global provision is not, in principle, set up for that unrealised loss. In that case, the provision is progressively set up on the shorter of either the useful life of the fixed asset or the duration of the loan.

c) When the due dates for transactions are relatively near to each other, unrealised losses and gains may be regarded as elements of the same global exchange position and the expense to the provision may be limited to the amount of losses in excess of gains.

d) When the interest expense relating to a loan in foreign currencies is less than it would have been had the loan been made in francs, the amount of the annual expense to the provisions for exchange losses may be limited to the difference between this deemed interest expense and the actual interest expense.

e) When the unrealised losses are attached to operations concerning several periods, the enterprise may allocate these losses between such periods, using methods that have to be justified. In any case, the chosen method cannot be changed without good reason.

Notes to the accounts

The enterprises must disclose in the notes information as to the nature, amount and accounting treatment of differences arising from the conversion into national currency of the elements expressed in foreign currencies (decree 29 November 1983, art. 24.5).

C. FIXED ASSETS INCLUDING INVESTMENTS

They are translated using the historical rate method.

D. INVENTORIES

Inventories held abroad are translated at an average of the different rates existing on dates of purchase.

E. INCOME STATEMENT ITEMS

Not provided for by law.

Long-term items are not treated differently from short-term items, except in the following two instances:

- setting-off of positive and negative translation differences (see above) is normally carried out on short-term items only;

- negative translation differences on foreign currency borrowings, financing fixed assets or investments located in the corresponding foreign country are deferred and amortised over the shorter of the borrowing term and the useful life of the asset (see above).

1.2. Consolidated accounts

The same provisions as those for annual accounts apply.

In addition, it must be noted that the French accounting rules concerning consolidated accounts allow for the use of an alternative conversion method from that used to prepare the annual accounts of companies comprised within the scope of consolidation.

According to the article 248-8 of Decree of 23 March 1967, modified by the Decree of 17 February 1986, the foreign currency translation accounts on the balance sheet may be transferred to the consolidated income statement. As a consequence, the provision relating to the unrealised translation loss is reversed.

2. Treatment of foreign operations

2.1. Annual accounts

No provision, except for investments, as defined above, which are translated using the historical rate method. The equity method is seldom used in annual accounts and in circumstances strictly defined by law. Further, the French accounting rules (Plan comptable, page II.121) provide that the balance sheet items of a foreign branch of an enterprise are included in the balance sheet of this enterprise as if the assets and liabilities of the branch had been directly acquired or incurred by the enterprise.

2.2. Consolidated Accounts

A distinction is made between integrated (dependent) and non-integrated (independent) foreign affiliated companies.

Under the Plan comptable two methods are allowed: temporal method or closing rate method.

Temporal method (historical rate method)

Non-monetary items are translated at historical rate. Monetary items are converted at closing rate.

Revenues and expenses are converted at the rate existing on the date of the transaction; in practice, an average rate is usually used.

Translation differences on monetary items which were in the opening balance sheet are recorded in a specific caption of the consolidated income statement ("Ecarts de conversion"). Translation differences on income statement items are recorded in the same caption of the consolidated income statement.

This method is usually used by entities which form an integral part of the parent company's activities.

Closing rate method

All balance sheet items are converted using the closing rate (except capital and reserves). Income statement items are converted at the closing rate. An option is open to entities

whose activity is better reflected by converting the income statement at an average rate for the period. Translation differences on both balance sheet and income statement items are recorded in the consolidated shareholder's equity, representing their share of the group, under the caption "Translation differences" ("Ecarts de conversion") with the portion relating to minority interests directly included in this caption.

This method is usually used for independent entities.

Entities affected by a high inflation rate

Two possibilities are available:

- temporal method
- restatement of annual accounts of the subsidiary to correct for the effects of inflation, followed by translation at the closing rate.

All significant information concerning the method of conversion used and analysis of the differences resulting from their integration into the consolidated accounts must be disclosed (article 248-12, 3 of the Decree of 23 March 1967; Plan comptable, pages II.157, II.169, II.171, II.173).

The French accounting rules do not contain any provision on the treatment of monetary items relating to affiliated companies and as a consequence they are usually not treated differently.

Greece

- All foreign currency monetary items are translated at the closing rate in the financial statements, except for those concerning prepayments or non-cancellable commercial credits for orders given abroad or receive therefrom;
- Exchange differences, positive and negative, are set against each other per foreign currency with a distinction between those exchange differences arising form short term transactions and those arising from long term transactions.
- Exchange gains from short-term transactions are recorded as deferred income, while exchange losses are recorded as an expense.
- A similar practice is followed for exchange differences from long-term transactions, except for those arising from long-term credits used by an entity to acquire or construct fixed assets, which are recorded in the books as deferred expense or income and are recognised in the income statements of future periods as the relating credit is repaid.
- No other distinction is made in the treatment of translation differences on long term foreign currency monetary items.
- No distinction is made between integrated (dependent) and non-integrated (independent) foreign branches and subsidiaries.
- Monetary items relating to affiliated companies are not treated differently.
- The annual accounts of foreign operations that are going to be included in the consolidated accounts are translated into local currency by that method in accordance with which monetary items are translated at the closing rate and other items are translated at the rates existing when the relevant assets were acquired.
- The profit and loss account of the annual accounts of the foreign operation is translated at the average of the rates of the accounting period.

- Exchange rates used for translation of foreign currency monetary items together with the accounting treatment of the exchange differences resulting from the translation should be disclosed. The amounts of exchange differences recorded in the income statement should be disclosed.

Portugal

1.1. Annual accounts:

In general all foreign currency monetary items are translated at the closing rate in the financial statements.

The Official Chart of Accounts provides:

A. Cash

Cash is translated on the bases of the closing rate. Any positive or negative translation difference is recognised in the profit and loss account.

B. Receivables and liabilities

Receivables and liabilities expressed in foreign currencies are recorded in ESC (escudos) on the basis of the operating date, unless the rate of exchange is fixed between the parties or guaranteed by a third party.

On the closing date, the above receivables and liabilities are translated on the basis of the closing rate.

In general, these conversion differences are recognised in the profit and loss account.

As regards positive translation differences resulting from medium and long term liabilities, they should be deferred if there is a reasonable expectation that the gain will reverse. On the date of payment or the date of receipt they are transferred to the profit and loss account.

The translation differences on loans relating to fixed assets may be allocated to the cost of those assets during the period of construction.

1.2. Consolidated accounts

The same provisions as those for annual accounts apply.

Spain

1. Annual Accounts

- All foreign currency monetary items are translated at the closing rate in the financial statements.
- Negative translation differences shall be charged against earnings of the accounting period in which they occur.
- Positive translation differences occurring in the translation of foreign currency cash or its equivalent items are considered realised and are taken to earnings.
- All other positive translation differences are deferred until settlement, except to the extent that they may be set off against negative translation differences, in an account entitled "Income deferred over various periods".

For each group of homogeneous items for which negative translation differences have been charged against earnings of the current or prior years, related unrealised positive translation differences may be taken to earnings to the amount by which the negative translation differences exceed related positive translation differences taken to earnings in prior years.

Positive translation differences deferred in prior years shall be taken to earnings when the related items mature or to the extent that negative translation differences are recognised for an equal or greater amount in each group of homogeneous items.

Spanish standard recognises as a homogeneous group those items which mature in the same year in the same currency or in currencies which, though different, are officially convertible in Spain.

- Special standards may be laid down which are applicable to specific industries or sectors with heavy long term debts in foreign currency. Up till now special standards have been approved for regulated companies, whose prices are subject to approval by an administrative body, and for the air transport sector.

- No distinction is made in the treatment between translation differences on long term and short term foreign currency monetary items. However, a special treatment is required for differences arising on long term foreign currency loans which are specifically related to financing the acquisition of tangible fixed assets.

- Monetary items which relate to affiliated companies are not treated differently.

2. Consolidated accounts

- A distinction is made between integrated and non-integrated foreign subsidiaries.

- In the translation of the annual accounts of foreign subsidiaries to be included in the consolidated accounts the closing rate/net investment method shall generally be used.

  Under this method the balance sheet items, excluding shareholders' equity, shall be translated at the closing rate. Shareholders' equity is translated at the historical rate of exchange. Translation differences, once the portion corresponding to minority interests has been deducted, are recorded under a specific heading within shareholders' equity on the consolidated balance sheet.

  Earnings and expenses included in the profit and loss account of the foreign company will be translated at the rate of exchange applicable on the date of the transaction. An average of exchange may be used.

- The monetary/non monetary method (temporal method) will be used for translating annual accounts of foreign subsidiaries under any of the following circumstances :

  1. The activities of foreign companies can be considered as an extension of those of the Spanish parent company.

  2. The foreign company operates in an area of high inflation rates and its annual accounts have not been adjusted for inflation.

Using this method, monetary items on the balance sheet of the foreign subsidiary shall be translated at the closing rate, while non-monetary items shall be translated at the historical rate of exchange. Translation differences shall be attributed to the consolidated profit and loss account under a specific heading.

The criteria used to translate the profit and loss account are the same as for the previous method, except for income and expenses relating to non-monetary items, which shall be translated at an historical rate of exchange.

3. Disclosure requirements

Both for the annual accounts and consolidated accounts, information shall be provided on :

- Valuation criteria for foreign currency balances.
- Procedure used to calculate the exchange rate in pesetas of items which are, or were originally, expressed in a foreign currency.
- Accounting treatment of translation differences.

2. Rules issued by other regulatory bodies on foreign currency translation

Foreign Currency Translation is not addressed by other regulatory bodies in the following countries:

- Denmark
- Germany
- Greece
- Ireland
- Italy
- Luxembourg

However, in **Denmark**, the Danish Financial Supervisory Authority has issued a notice concerning the financial reporting of banks in which the treatment of foreign currency translation is stated.

In **Germany** the tax rules follow the accounting rules. In **Luxembourg** separate requirements exist for insurance companies which are outside the scope of this document.

The **French** standard-setter (the CNC) has set up a working group to largely modify the accounting rules as far as translation differences are concerned.

The following gives a summary of the requirements in those countries where foreign currency translation is addressed by regulatory or supervisory bodies apart from the law:

Belgium

The "Commission des Normes Comptables" issued in December 1987 an Advice about the operations, assets and commitments in foreign currencies. The sections VII and VIII of this Advice deal with the valuation at the end of the book year, of non-specifically hedged

assets and commitments, expressed in foreign currencies, and with the treatment of translation differences.

The Advice points out that the closing rate method is the most used method. An average rate of the last month before the end of the book-year, or of the fortnight before and the fortnight after this date, may also be used.

Translation differences are deferred without prejudice to the principle of prudence regarding the treatment of concealed charges. Netting of positive and negative differences in the same foreign currency (or of currencies which, de jure or de facto, are closely bound so that they represent a sole exchange risk) is requested. No netting may occur in all other cases.

Negative translation differences have to be accounted for among the charges, through the entry:

- 655 Unrealised exchange losses resulting from translation of foreign currencies

- to 496 Deferral of translation of foreign currencies.

Positive translation differences are maintained in the balance sheet on the liabilities side under the caption 497 (same heading as 496).

Although the Commission recommends a prudent application of the realisation principle, and to distinguish between realised exchange losses or gains on the one hand, and unrealised exchange losses or gains from translation of foreign currencies on the other hand, it does not want to rule out the adoption by an enterprise of a policy of immediate expression in the income statement of all exchange losses or gains, whether realised or not. The requirements are that this policy would be permanent and that its adoption would be clearly disclosed in the notes under the valuation rules. This tolerance is meant for affiliated companies.

As the same opportunities of hedging exist regarding both long term and short term foreign currency monetary items, no distinction is made, except that unrealised translation differences on cash at bank and in hand are considered as realised, and, as such, taken to income rather than being deferred.

The same applies to differences on financial debts relating to credit institutions, provided these debts are a means of payment.

France

The Stock Exchange Commission (COB) has issued, for companies listed on the French Stock Exchange, additional requirements also covering long-term exchange contracts, hedges, options, guarantees, futures, etc., but which are not in contradiction with the legal requirements.

Netherlands

The Dutch Council of Annual Reporting issued in 1985/1986 guidance on foreign currency translation, which was revised in March 1994. The most relevant paragraphs are quoted in the following:

Transactions in foreign currencies

906 Transactions in foreign currencies settled during the reporting period should be included in the annual accounts at the exchange rate used for settlement.

907 If transactions have not been settled at balance sheet date, the resultant debtors or creditors should be included in the balance sheet at the rate of exchange prevailing on balance sheet date. Where the exchange risk has been hedged, this shall be taken into account in determining the results.

908 The transactions referred to in paras. 906 and 907 result in profits and losses on exchange. As regards the treatment of these exchange results, the distinction between short-term and long-term transactions is crucial. Exchange profits and losses on short-term transactions should be included in the profit and loss account for the period in which they arise, either separately or netted off, unless the provisions of paras . 921 or 922 are applicable.

909 Exchange losses on long-term transactions should be charged to the result in the period in which they occur, apart from the exceptions referred to in paras. 911, 921 and 922.

910 Exchange profits on long-term transactions (with the exception of the exchange differences discussed in paras. 911, 921 and 922) shall be credited to the result, preferably in the period in which they occur. It is however permissible to recognise exchange profits on long-term transactions pro rata over the remaining term. That part of such differences not yet recognised should then be included in the balance sheet as deferred income. Subsequent exchange losses on long-term transactions in the same currency are deducted from this deferred income.

911 If forward contracts are entered into to hedge the exchange risk on long-term transactions in foreign currencies, valuation at the forward rate in accordance with para. 907 can involve a difference between the spot rate at the time of concluding the forward contract and the forward rate at which the forward contract will be settled. This difference is primarily due to differences in interest rates. For this reason, the difference should be spread over the period of the forward contract. If loans or forward contracts are concluded to hedge future cash flows in foreign currencies and provided that it is reasonable to suppose that the exchange risks on the principal will be covered by these cash flows, it is permissible not to recognise exchange differences on these loans or forward contracts which may be apparent at balance sheet date until such time as the loan is repaid or the contract matures. This implies, therefore, that under the stated conditions, these gains and losses on exchange on loans and forward contracts may be recognised in the period in which the cash flows concerned occur.

Translation in the case of foreign activities

913 Foreign activities are divided into :

a) Activities in foreign units

A foreign unit is a form of foreign activity involving independent activities with little or no connection between the cash flows associated with these activities and those of the reporting company. The assumption is that the reporting company is merely exposed to an exchange risk on its net investment, regardless of the assets in which this net investment is tied up. By net investment is meant the reporting company's share in the shareholders' equity of the unit (see also para. 921).

b) Direct foreign activities

All forms of foreign activity not coming under the heading of foreign units shall be treated as direct foreign activities. The reporting company shall treat the assets and liabilities of the direct foreign activity as its own. The underlying currency translation principle in the case of direct foreign activities is that each asset and liability represents a separate exchange risk. Assets, liabilities, income and expenses are to be translated item by item.

914 For each of their foreign participating interests included in the consolidation, legal entities should classify the activity on the basis of the criteria set forth in para. 913 either as a foreign unit or as a direct foreign activity for the purpose of preparing the annual accounts. It is acceptable in the consolidated annual accounts to treat all foreign activities as falling into one of the two categories, depending on the nature of the most important foreign activity, but for each category there are separate rules for foreign currency translation and the treatment of exchange differences. The decision, once made, becomes part of the accounting policies and cannot be changed without good reason (cf. Chapter 1.06 Changes in accounting policies).

Non-consolidated foreign participating interests should be classed as foreign units.

915 It is also important with respect to the calculation and processing of translation differences whether the company is using the current cost or historical cost convention as valuation principle.

Foreign unit/current cost

916 Assets and liabilities of foreign units should be translated at the exchange rate prevailing on balance sheet date when the current cost convention applies. In this case, a translation difference shall be calculated on the opening balance of shareholders' equity. This translation differences should be credited or debited directly to the shareholders' equity of the reporting parent company.

Foreign unit/historical cost

917 Assets and liabilities of foreign units should be translated at the exchange rate prevailing on balance sheet date where the historical cost convention is applied, having due regard to the stipulations of para. 920, as necessary. The translation difference on the opening balance of the shareholders' equity should be credited or debited directly to shareholders' equity.

918 The annual accounts of foreign units in countries with a high rate of inflation should be adjusted for the effects of price rises prior to translation. Translation differences should then be reflected directly in shareholders' equity. Alternatively in this situation, it is permissible to translate the assets, liabilities, income and expenses on an individual basis by treating the foreign unit as a direct foreign activity, as explained in para. 924. In that case, the translation differences should be taken to the profit and loss account. The rate of inflation shall be deemed to be high if it totals 100 % or more over a period of three years.

Foreign unit/current cost or historical cost

919 Foreign unit profit and loss account items shall be translated either at the exchange rate on balance sheet date or at the average exchange rates for the period. If the individual items of the foreign unit's profit and loss account are translated at the average exchange rates for the period, the net result may be translated either (a) at the average exchange rate or (b) at the exchange rate prevailing on balance sheet date. In the first case (a), a translation difference will arise because the share of the reporting company in the result of the foreign unit will be translated at the average exchange rate while the share of the reporting company in the shareholders' equity, which includes the foreign unit's result for the year, will be translated at the exchange rate prevailing on the balance sheet date. This translation difference should be reflected directly in the shareholders' equity of the reporting company. The translation difference arising in case (b) on the translation of the foreign unit's profit and loss account should be taken to the profit and loss account.

920 Translation differences arising out of other movements in the foreign unit's shareholders' equity (for example revaluation, interim capital increases) should be reflected directly in shareholders' equity.

921 Where debtors and creditors on intercompany accounts in fact represent an increase or decrease in the net investment of the parent company in the foreign unit, then - contrary to the stipulations of paras 908-911- the exchange differences arising on these debtors and creditors should be reflected directly in shareholders' equity.

922 If a foreign currency loan is contracted to finance or hedge the net investment in a foreign unit, then - contrary to the stipulations of paras 908-911- the exchange differences arising on the loan should be reflected directly in shareholder's' equity to the extent that they are effectively a hedge against the exchange differences arising on the net investment.

Direct foreign activity/current cost

923 Where the current cost convention is applied, assets and liabilities of direct foreign activities should be translated at the exchange rate prevailing on balance sheet date and the difference arising on this translation should be treated :

- in the case of items for which a revaluation reserve has been formed, as part of the revaluation reserve;
- in the case of other items, as part of the result on ordinary activities.

Direct foreign activity/historical cost

924 The assets, liabilities, income and expenses of a direct foreign activity should be translated as if they were actually part of the annual accounts of the reporting company.

925 In the profit and loss account, the items relating to balance sheet items translated at historical exchange rates should also be translated at historical exchange rates. The other profit and loss account items should be translated at exchange rates prevailing at the time of their book entry by the direct foreign activity, or at average exchange rates.

926 The translation differences on direct foreign activities should be included in the profit and loss account as part of the result on ordinary activities, having regard to the stipulations of paras. 910 and 911.

The non-consolidated annual accounts

927 In the no consolidated annual accounts, the translation difference son consolidated foreign participating interests should be treated in the same way as in the consolidated annual accounts (taken directly to the profit and loss account or via the balance sheet) except that the analysis of shareholders' equity can be omitted in the consolidated annual accounts pursuant to the provisions of Section 10 of the Annual Accounts Formats Decree.

929 Both the translation differences on retained profits of foreign participating interests arising since the implementation of Part 9, Book 2 of the Netherlands Civil Code, for which a statutory reserve should be formed as referred to in Section 489, subsection 4, of Book 2 of the Netherlands Civil Code, and the other translation differences of foreign participating interests (with the exception of the differences referred to in para. 928) should be treated as non-distributable.

931 The translation differences reflected directly in shareholders' equity pursuant to the provisions of paras 916-922 should be included in shareholders' equity, according to their nature, as follows:

a) as part of a revaluation reserve;
b) as part of a statutory reserve for participating interests as referred to in Section 389, subsection 4, Book 2 of the Netherlands Civil Code;
c) as a separate non-distributable reserve for translation differences.

933 The accounting policies relating to the translation and treatment of exchange differences on transactions and positions should be explained separately for the balance sheet and the profit and loss account, including an explanation of the decision taken pursuant to para. 914. If it is decided not to use the same method for all foreign activities, an indication should be given of the relative importance of direct foreign activities as opposed to foreign units.

934 If exchange differences pursuant to para. 910 or para 911 are treated as accruals, the related amount of the balance sheet item concerned should be disclosed.

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936 The amounts of the translation differences on foreign activities reflected directly in shareholders' equity or taken to the profit and loss account should be disclosed in the notes.

Portugal

In the absence of legal requirements the Portuguese "Comissao de Normalizaçao Contabilistica" standard-setting body recommends the application of International Accounting Standards issued by IASC.

Spain

In 1991 the Bank of Spain laid down specific regulations for credit institutions (Circular 4/1991, of July 14th) which have recently been modified in circular 4/1993 of 26th March to bring them into line with community directives.

United Kingdom

The accounting standard SSAP 20 "Foreign Currency Translation" was issued by the former standard setting body the Accounting Standards Committee (ASC). The ASC operated under a body owned by the various UK accounting bodies. It has since been adopted by the new independent standard setting body, the Accounting Standards Board (ASB). SSAP 20 defines 'best accounting practice' in the area of foreign currency translation. Its requirements would also be very influential in determining the correct implementation of the legal requirement to give a "true and fair view". The most relevant paragraphs of SSAP 20 are quoted in the following paragraphs.

Annual accounts

"46. Subject to the provisions of paragraphs 48 and 51 each asset, liability, revenue or cost arising from a transaction denominated in a foreign currency should be translated into the local currency at the exchange rate in operation on the date on which the transaction occurred; if the rates do not fluctuate significantly, an average rate for a period may be used as an approximation. Where the transaction is to be settled at a contracted rate, that rate should be used. Where a trading transaction is covered by a related or matching forward contract, the rate of exchange specified in that contract may be used.

47. Subject to the special provisions of paragraph 51, which relate to the treatment of foreign equity investments financed by foreign currency borrowing, no subsequent translations should normally be made once non-monetary assets have been translated and recorded.

48. At each balance sheet date, monetary assets and liabilities denominated in a foreign currency should be translated by using the closing rate or, where appropriate, the rates of exchange fixed under the terms of the relevant transactions. Where there are related or matching forward contracts in respect of trading transactions, the rates of exchange specified in those contracts may be used.

49. All exchange gains or losses on settled transactions and unsettled short-term monetary items should be reported as part of the profit and loss for the year from ordinary activities (unless they result from transactions which themselves would fall to be treated as extraordinary items, in which case the exchange gains or losses should be included as part of such items).

50. Exchange gains and losses on long-term monetary items should also be recognised in the profit and loss account; however, it is necessary to consider on the grounds of prudence whether, in the exceptional cases outlined in paragraph 11, the amount of the gain, or the amount by which exchange gains exceed past exchange losses on the same items to be recognised in the profit and loss account, should be restricted.

51. Where a company has used foreign currency borrowing to finance, or provide a hedge against, its foreign equity investments and the conditions set out in this paragraph apply, the equity investments may be denominated in the appropriate foreign currencies and the carrying amounts translated at the end of each accounting period at closing rates for inclusion in the investing company's financial statements Where investments are treated in this way, any exchange differences arising should be taken to reserves and the exchange gains or losses on the foreign currency borrowing should then be offset, as a reserve movement, against these exchange differences. The conditions which must apply are as follows:

(a) in any accounting period, exchange gains or losses arising on the borrowing may be offset only to the extent of exchange differences arising on the equity investments;

(b) the foreign currency borrowing, whose exchange gains or losses are used in the offset process, should not exceed, in the aggregate, the total amount of cash that the investments are expected to be able to generate, whether from profits or otherwise; and

(c) the accounting treatment adopted should be applied consistently from period to period."

This means specifically that foreign currency monetary items are translated at the closing rate unless a hedging rate is used in accordance with paragraph 48. Positive translation differences are fully set off against negative translation differences (paragraph 60, as quoted below). The Standard requires the immediate recognition of exchange differences through the profit and account and so no net balance should ever be deferred. However, paragraph 50 suggests that, in some cases, prudence might require that the recognition of particular exchange gains through the profit and loss account should be restricted. One way of doing this would be to credit the gain to a deferral account. The standard is silent on where such deferral should be disclosed. In exceptional cases a difference is made in the treatment between translation differences on long term and short term foreign currency monetary items.

Paragraph 51 deals with monetary items financing investments affiliated companies. It permits the offset against reserves of exchange gains/losses on borrowings to the extent that they arise on the equity investments. It limits the foreign currency borrowings, whose exchange gains or losses are used in the offset process to the aggregate of the total amount of cash that the investments are expected to be able to generate, whether from profits or otherwise.

Consolidated accounts

"52. When preparing group accounts for a company and its foreign enterprises, which includes the incorporation of the results of associated companies or foreign branches into those of an investing company, the closing rate/net investment method of translating the local currency financial statements should normally be used.

53. Exchange differences arising from the translation of the opening net investment in a foreign enterprise at the closing rate should be recorded as a movement on reserves.

54. The profit and loss account of a foreign enterprise accounted for under the closing rate/net investment method should be translated at the closing rate or at an average rate for the period. Where an average rate is used, the difference between the profit and loss account translated at an average rate and at the closing rate should be recorded as a movement on reserves. The average rate used should be calculated by the method considered most appropriate for the circumstances of the foreign enterprise.

55. In those circumstances where the trade of the foreign enterprise is more dependent on the economic environment of the investing company's currency than that of its own reporting currency, the temporal method should be used.

56. The method used for translating the financial statements of each foreign enterprise should be applied consistently from period to period unless its financial and other operational relationships with the investing company change.

57. Where foreign currency borrowings have been used to finance, or provide a hedge against, group equity investments in foreign enterprises, exchange gains or losses

on the borrowings, which would otherwise have been taken to the profit and loss account, may be offset as reserve movements against exchange differences arising on the re-translating of the net investments provided that:

(a) the relationships between the investing company and the foreign enterprises concerned justify the use of the closing rate method for consolidation purposes;

(b) in any accounting period, the exchange gains or losses arising on foreign currency borrowings are offset only to the extent of the exchange differences arising on the net investments in foreign enterprises;

(c) the foreign currency borrowings, whose exchange gains or losses are used in the offset process, should not exceed, in the aggregate, the total amount of cash that the net investments are expected to be able to generate, whether from profits or otherwise; and

(d) the accounting treatment is applied consistently from period to period.

58. Where the provisions of paragraph 51 have been applied in the investing company's financial statements to a foreign investment which is neither a subsidiary nor an associated company, the same offset procedure may be applied in the consolidated financial statements."

A distinction is made between integrated (dependent) and non-integrated (independent) subsidiaries, as described under paragraphs 52 and 55.

Disclosures

"59. The method used in the translation of the financial statements of foreign enterprises and the treatment accorded to exchange differences should be disclosed in the financial statements.

60. The following information should also be disclosed in the financial statements:

(a) for all companies, or groups of companies, which are not exempt companies, the net amount of exchange gains and losses on foreign currency borrowing less deposits, identifying separately:

(i) the amount offset in reserves under the provisions of paragraphs 51, 57 and 58; and

(ii) the net amount charged/credited to the profit and loss account;

(b) for all companies, or groups of companies, the net movement on reserves arising from exchange differences."

3. Recommendations for foreign currency translation issued by national professional bodies

In the following countries the national professional bodies have not issued any recommendations or rules on foreign currency translation:

- Belgium

- France

- Greece

- Luxembourg

- Netherlands
- Portugal
- Spain
- United Kingdom

For the **Netherlands** it should be noted that NIVRA participates in the Council for Annual Reporting and does therefore not issue any recommendations on annual reporting themselves.

In **Spain**, within the last few years various national associations have issued recommendations but, on the publication of the Spanish General Accounting Plan on 1 January 1991, these are now superseded.

In the **United Kingdom** SSAP 20 was developed by the accounting profession (ASC - Accounting Standards Committee). However, the ASC has now been superseded by the Accounting Standards Board (ASB) which is a regulatory body independent of the accounting profession. The ASB has adopted all SSAPs.

The following gives a summary of the recommendations on foreign currency translation issued by national professional bodies:

Denmark

In May 1994, the Accounting Principles Committee of the FSR issued a draft accounting standard concerning "Foreign Currency Translation". The standard becomes operative on 1 July 1995.

Companies quoted on the Copenhagen Stock Exchange have, under the rules of the stock exchange, an obligation to prepare their annual accounts in accordance with the national accounting standards.

In brief, the contents are as follows:

<u>Transactions in foreign currency</u>

1. Transactions in foreign currency are translated according to the exchange rate ruling at the date of the transaction.

2. Monetary items are, under the main rule, translated at the exchange rate ruling at the balance sheet date (exceptions, see Hedging).

3. Positive as well as negative translation differences are recognised as income or as expenses for the period (exceptions, see Hedging).

4. There is no differentiation between realised and unrealised differences.

5. There is no differentiation between the differences concerning short-term and long-term items. According to the Standard it will not be permitted to defer recognition of exchange differences concerning long-term items (exceptions, see Hedging).

6. Monetary items concerning affiliated companies are in certain cases treated differently from that required under the main rule.

   These cases are:

- An inter company account which is in reality an addition to or a deduction from the reporting company's net investment in an independent foreign entity. If the net investment is treated according to the equity method, exchange differences concerning the inter company account should be taken directly to equity.

  If the investment is treated according to cost value and if the inter company account is exchange adjusted, the exchange adjustment should not be recognised in the income statement or taken to equity until the investment is realised.

- A borrowing for the purpose of hedging a net investment in an independent foreign entity that in reality is an efficient hedging. If the net investment is treated according to the equity method, an exchange-rate difference concerning the inter company account must be taken directly to equity as far as it is counterbalanced by an exchange-rate difference concerning the net investment.

  If the investment is treated according to cost value, the exchange-rate adjustment of the inter company account should not be recognised in the income statement or taken to equity, until the investment is realised.

Hedging

7. The accounting treatment of exchange adjustment of hedging transactions depends on whether the hedged item, the hedging transaction or both have been included in the balance sheet and whether the hedged item should be adjusted.

   If only the hedged item has been included in the balance sheet and has been adjusted, the hedging transaction should also be adjusted and both adjustments must be included in the profit and loss account. The adjustment of the hedging transaction included in the profit ands loss account at the balance sheet date should be stated in the balance sheet as debtors or creditors.

   If only the hedging transaction has been included in the balance sheet and has been adjusted, this adjustment must be postponed until the hedged item is realised. The adjustment of the hedging transaction recorded in the profit and loss account at the balance sheet date should be stated in the balance sheet as an accrual.

8. If the hedged item and the hedging transaction are not included in the balance sheet, the foreign-exchange rate adjustment should not appear in the financial statements until the hedged item is realised.

9. If the company has entered into a forward exchange contract in order to hedge a monetary item to prevent exchange risks, the premium, which is the difference between the forward rate and the spot rate at the inception of the contract, should be carried to the income statement over the life of the contract.

10. If a company has entered into a short term forward exchange contract in order to hedge a short-term monetary item, the item may - for practical reasons - be carried in the balance sheet at the forward rate without amortisation of the premium over the life of the contract, if this does not, in a material way, change the result.

11. The following conditions should be fulfilled in order to make certain that a transaction, balance sheet item, forward contract, etc., may be considered as having been entered into for the purpose of hedging:

- the hedged item exposes the company to a foreign exchange risk;
- the hedging transaction should be efficient in order to reduce these risks;
- the hedged item and the hedging transaction should be identified as such.

It must apply to an expected future transaction that it is probable that the transaction resulting in the hedged foreign currency position will be implemented. This means that there is no reason to believe that a foreign currency position can be hedged. All significant characteristics and conditions for the expected transaction must be known, including the time of the implementation of the transaction, the type of transaction and the size of the amount.

Translation of the financial statements of foreign operations

12. The method of translation depends on whether it is an integrated or an independent foreign entity in accordance with the classification of IAS 21.

13. The temporal method is used for translation of financial statements of integrated operations. The closing rate/net investment method is used for translation of financial statements of independent foreign entities.

14. When the closing rate/net investment method is applied, the income statement should be translated using the exchange rates ruling at the dates of the transactions. The exchange difference is taken directly to equity.

    If it involves great difficulties to translate the income statement to the exchange rates ruling at the dates of the transactions, periodic average rates may be used, assuming that these provide a result that does not deviate substantially from the application of the exchange rates ruling at the dates of the transactions.

15. Also when using the temporal method the exchange rate ruling at the dates of the transactions are applied when translating the items of the income statement. However, profit and loss items derived from non-monetary items are translated using historical exchange rates.

16. If the financial statements of a non-integrated foreign operation is prepared in a currency influenced by high rates of inflation, the financial statements should be adjusted for the effects of inflation before being translated to Danish Kroner (DKK). If a true and fair view is not obtainable, the non-integrated foreign operation should not be included in the consolidation.

17. Principally, high inflation rates exist when the inflation of the local currency has accumulated 100 % or more in the recent 3 years.

Disclosure in annual accounts

18. The methods applied for the foreign currency translation must be described in the disclosure of the accounting policies used. The description must cover the treatment of foreign currency transactions as well as the translation of the financial statements of foreign operations.

19. Exchange differences that are unusual and have a considerable influence on the result of the year, on the balance sheet or equity, respectively, must be mentioned separately or be specified in the notes, and they should usually be mentioned in the annual report.

20. In the notes on the annual accounts the following must be disclosed:

- exchange differences taken directly to equity;
- exchange adjustments relating to amounts carried in the previous year's balance sheet should be disclosed separately in the notes for balance sheet items in which the changes of the year are specified;
- net exchange differences concerning integrated foreign operations carried to income;
- material exchange adjustments recorded in the balance sheet in accordance with hedging;
- the accounting treatment of hedging of expected future transactions requires information about the type and scope of the hedged expected future transactions as well as the period up to their realisation.

21. In enterprises whose exchange rate situation is of material importance for the expected development, it is recommended that the annual accounts discloses information about the enterprise's policy regarding control of exchange risks.

22. If the annual accounts are influenced by conditions in exchange rates that are essential to the understanding of the annual accounts, a statement to this effect should usually appear in the annual report. Also, the annual report should disclose exchange-rate changes subsequent to the end of the accounting year of considerable importance to the assessment of the annual accounts. The information should contain a description of the financial effect of the exchange-rate changes.

Consolidated accounts

In principle there is no difference between annual accounts and consolidated accounts in relation to the above.

It should be noted that the Standard in some points goes further than the practice used for the preparation of a great number of "today's" annual accounts.

Germany

In 1986, after implementation of the Fourth and Seventh Directives into German law the IDW published a Draft Statement on Foreign Currency Translation which was also discussed with other communities interested in accounting and which contains the presently applicable accounting principles relating to foreign currency translation. One of the reasons for not adopting this draft in the form of a final statement was the pending international evolution (refer to the publication "Die Wirtschaftsprüfung 1986, page 664 ssq.).

- The closing rate method is not generally used in the statutory financial statements. The closing rate is used for recognition of unrealised losses. As regards foreign currency translation in consolidated financial statements, a general use of the closing rate method is possible (see below).

  Since identical general valuations rules apply both for foreign currency items and for the relevant items in national currency (historical cost principle,

realisation principle, prudence concept), application of the closing rate method may be contrary to the aforementioned principles. This will for instance, be the case if the amount of an asset determined under the closing rate is higher than its cost of acquisition.

- Positive translation differences cannot be recognised in the evaluation of assets. They are not disclosed in annual accounts. Positive translation differences can be set off against negative translations differences under the conditions of hedging.

- Fundamentally there is no distinction between long term and short term items. For short term receivables and debts though, for which individual valuation is frequently difficult, it is considered permissible to use an approximation procedure. Also while in principle valuation of liquid capital in foreign currency may not exceed the acquisition cost, for the valuation of cash and currency account bank balances the balance sheet rate may be used.

- In principle, no difference is made between integrated and non-integrated foreign branches and subsidiaries. For stocks of a foreign permanent establishment recorded in foreign currency as an auxiliary for application of the lowest value method (Niederstwertprinzip) to the stocks expressed in foreign currency it is considered as admissible to classify the stocks according to their duration of storage and to translate into national currency the acquisition costs per class using the average rate of the period.

  As regards the consolidated accounts of a legally independent foreign subsidiary, the application of the closing rate would also be permitted.

- Long term monetary items relating to affiliated companies would be valued at the historical rate.

Consolidated accounts

For foreign currency translation in consolidated financial statements the draft allows application of both the closing rate and more differentiated methods (in particular also the temporal method). The method chosen should be applied on a consistent basis unless material reasons warrant a modification (consistency).

When applying the closing rate method, expenses and revenues set out in the profit and loss account can either be translated using the closing rate at the balance sheet date or - more in line with the character of the profit and loss account as an account reflecting a certain period of time - using average rates (average of the year, of the quarterly period or of the month). Resulting translation differences are to be included under the items "other operating expenses" and "other operating income" or to be disclosed separately. Consequently the results of the year are always stated at the rate applicable at the balance sheet date. For countries with high inflation a previous adjustment for inflation effects is required.

When applying the temporal method, translation differences result from the application of different translation rates which should be recognised under income. Positive translation differences, which result in an increase in income, may be neutralised by means of setting up provisions for foreign currency risks or may be recorded without effecting the income statement and set off against equity capital. In cases where modifications of the translation differences accounted for are recognised under income, these have to be separately disclosed in the profit and loss account under the heading "other operating income" and

"other operating expenses". The same applies for any additional translation difference resulting in the profit and loss account from the use of different translation rates.

Disclosures

In addition to the legal disclosure requirements regarding foreign currency translation methods used in individual and consolidated financial statements, the draft requires additional disclosures.

Thus, for instance, there is a requirement to disclose the method applied in accounting for closed foreign currency positions. In addition, application of the closing rate method in consolidated financial statements makes it necessary to give in the annex information on the modifications resulting from the change in exchange rates between the balance sheet dates, unless such information is separately disclosed in the financial statements.

When using the closing rate for translation of balance sheet items any diverging treatment of expenses and revenues (such as for instance using average rates) has to be explained. When applying historical rates, specific mention is required of these items translated at historical cost and of those items to which the closing rate was applied. The rates used for the translation of expenses and revenues also require special explanation.

Notwithstanding the translation method used, important exchange rate fluctuations and their consequences for material items in the consolidated accounts should be disclosed. The effects of translation differences on the group's equity capital require explanation, as well. Treatment of differences resulting from the application of diverging translation rates in the profit and loss account must also be mentioned.

To the extent that for the translation of individual annual accounts other methods than those generally applied are used (for instance for financial statements in highly inflationary countries), this has to be indicated and substantiated.

Ireland

The accounting requirements of the profession regarding this matter are contained in Statement of Standard Accounting Practice ("SSAP") 20 "Foreign Currency Translation". The details of SSAP 20 are described in part 2, "Rules issued by other regulatory bodies on foreign currency translation" under United Kingdom.

Italy

The Accounting Standard nr. 9 issued by the Committee of Dottori Commercialisti e Ragionieri, deals with accounting for transactions in foreign currency in the individual accounts of an enterprise.

The Accounting Standard Nr. 9 contains the following provisions:

1. Accounting

1.1. Transactions in a foreign currency deriving from financial or trading origin are recorded in the reporting currency using the exchange rate of the date on which the transaction occurs. The same method is applied in case of long-term debt settlement.

1.2. The exchange difference between the amount originally recorded and the settlement amount is regarded as a foreign exchange gain or loss either if the transaction is settled within the same accounting period or in subsequent periods.

2. Translation of foreign currency monetary items

2.1. Translation of foreign currency in cash

Foreign currency in cash is translated at the closing rate.

2.2. Translation of foreign currency short-term monetary items.

For the translation of short-term monetary items, deriving from either financial transactions of trade transactions, the closing rate is to be used. Gains and losses are recognised in income respectively as they are identified except in the following cases:

When the translation gives rise to only positive exchange differences and during the period from the closing date to the preparation of the balance sheet exchange rates may fluctuate such as to reduce materially that gain or transmute it into a loss, positive exchange differences have to be deferred and appropriate disclosure given in the notes to the accounts. The loss is recognised in the following financial year, but disclosed in the notes to the accounts.

The negative difference is recognised in the following financial year but appropriate disclosure is given.

As an alternative to the normal translation process described in the above paragraph, it is acceptable not to recognise in income the net positive exchange difference arising from the translation of all monetary items. In this case the following disclosures should be made:

(i) The amount of the foreign currency monetary items, analyzed by currency;

(ii) The amount of a/m items translated at the closing date rate, analyzed by currency;

(iii) Gains and losses which result from translation and the net positive exchange difference.

2.3. Translation of long-term foreign currency items

Exchange differences relating to long-term monetary items refers to exchange differences in respect of loans and trading transactions, translated at the closing rate, which are treated as follows:

(i) in the case of solely positive exchange differences, the exchange differences are deferred and recognised in income of future periods. Disclosure is given of the deferred gains.

(ii) In the case of solely negative exchange differences, these should normally be recognised in income for the period and the related monetary items are translated in the financial statement at the closing rate. Alternatively, at present, it is acceptable not to translate long-term monetary items. However, a provision is recognised in income for the period and the related amount is carried forward in the financial statements. Appropriate disclosure is given.

(iii) In the case of both positive and negative exchange differences, these should be aggregated according to the different classes of monetary items to which they relate. Gains are deferred and losses should normally be recognised in income for the period. Alternatively, at present, it is acceptable to apply the procedure of not translating long-term monetary items as described in paragraph (ii) above.

The Accounting Standard does not address the distinction that is made between integrated and non-integrated foreign branches and subsidiaries.

4. Treatment in practice of foreign currency translation in those countries where no legal requirements or recommendations exist in this area

Luxembourg

- Some companies transfer to the profit and loss account all the differences arising from the translation of monetary assets and monetary liabilities at the closing rate. Other companies defer, as transitory accounts in the balance sheet, the unrealised profit arising from this translation. Other companies compare the closing rate to the historical rate and only the unrealised losses arising from this comparison are recorded in their books, profits not being recorded.

- Companies which do not transfer to the profit and loss account all the differences arising from the translation at the closing rate, usually determine the unrealised losses after setting off the differences for which an economic link exists. It should also be taken into account that the forex position may be hedged by forward contracts. In such cases, forward contracts are considered before to determine the need to record unrealised losses.

- Unrealised profits on long term monetary items are generally not accounted for.

  Unrealised losses on long term monetary items are generally provided for. In some cases, the decision to recognise the unrealised losses is based on management's opinion of whether the decline in value is permanent or not.

- No distinction is made between integrated and non-integrated foreign branches and subsidiaries.

- Monetary items related to affiliated companies are in general not treated differently, but it could depend on the policies adopted for consolidation.

Consolidated accounts

- The most common method of translation of annual accounts of foreign operations to be included in the consolidated accounts is the closing rate/net investment method. However, none of the methods is required.

- The profit and loss account of the annual accounts of foreign operations included in the consolidated account is translated at average or closing rate. If average rate is used, the exchange difference is taken to reserves.

5. Disclosures in practice

The following summarises for each country what is disclosed in the accounts on foreign currency translation:

Belgium

Foreign currency translation requests the following disclosures in the notes:

1. In the financial statements of individual enterprises

   a) As information to be disclosed relating to the caption "Financial results" in the income statement:

      - realised exchange differences and unrealised exchange differences are recorded either as "other financial income" or "other financial charges" depending on their nature. With respect to theses captions, an analysis must be given of the items of which the amount is significant.

        But there is an exception if the exchange differences relate specifically to other income items in which case they may be included under the same

caption as the items concerned. In such a case, there can be no disclosure of these differences.

b) Together with the valuation rules must be disclosed:

- the method and criteria used for expressing in Belgian francs assets, debts and liabilities denominated in foreign currencies;

- the treatment of realised exchange differences and unrealised exchange differences on translation of foreign currencies in the financial statements.

2. In the consolidated accounts

In the notes must be disclosed:

a) The bases of translation applied to express in the consolidated accounts items which are, or originally were, expressed in a currency other than the currency in which the consolidated accounts are stated, and the translation in the consolidated accounts of the accounting statements of subsidiaries and associated enterprises governed by foreign law.

b) The translation differences with regard to:

- formation expenses;
- intangible fixed assets;
- tangible fixed assets;
- financial fixed assets.

Note: These translation differences are part of the "Movements", which must be disclosed, even as other items such as depreciation, reversals, revaluation etc.

Denmark

The legal requirements on disclosure are normally observed. The disclosure requirements of the draft standard as discussed in section 3 for Denmark are usually only followed by the larger companies. Disclosure requirements of the draft standard on treatment of exchange differences are probably only followed by a minority of companies.

France

The special accounts "écart de conversion - actif" and "écart de conversion - passif" are systematically disclosed in the balance sheet of the annual accounts. The disclosure requirements in the notes are generally respected by the French companies, either in their annual accounts or in their consolidated accounts. This leads listed companies to comply with IAS 21 or FAS 52 in their consolidated accounts.

In practice, companies would indicate the amount of the translation differences (assets and liabilities) and the amount of the provision for risks set up against negative differences.

Germany

The most recent surveys on annual and consolidated financial statements of important stock corporations and on the annual financial statements of medium-sized companies (IDW-Verlag 1990 and 1991) show that the relevant disclosures were made in the following manner: for translation of foreign currency receivables and liabilities in 92 out of 100 cases as regards the annual financial statements of big stock corporations and in 59 out of 100 cases as regards the annual financial statements of medium-sized companies. It has to be

borne in mind here that from the survey it cannot be deducted to what extent these items were material for assessment of the annual financial statements. In most cases, foreign currency receivables and/or liabilities were translated at the exchange rate prevailing at the date of their incorporation whereby unrealised profits at the balance sheet date were not considered while the relevant translation losses were recognised. Disclosures were also made on hedging transactions.

Greece

Accounting practice for disclosure within the financial statements is in conformity with the legal requirements.

Ireland

In practice the disclosure follows the legal requirements and SSAP 20.

Italy

In practice disclosure follows the legal requirements.

Luxembourg

Disclosures are limited to the description of the methods used to translate monetary items (and financial statements of foreign subsidiaries reporting in another currency than the parent company, in the case of consolidation).

Netherlands

From a survey of the 1986 accounts of large and medium-sized companies, it appears that in 86 % of cases, medium-sized companies disclose the translation method, and in 97 % of cases for large companies. Balance sheet items in foreign currency are translated at closing rate in 84 % of the cases for both medium-sized and large companies. The translation of transactions denominated in foreign currency in the profit and loss account is not usually disclosed. Those translation differences which are disclosed charged to the profit and loss account.

With regard to non-integrated foreign operations the closing rate/ net investment method is used in most cases.

A survey of the 1988 accounts of quoted companies underlines these results.

Portugal

Disclosures are limited to the description of the closing rates used to translate the items in foreign currency included in the balance sheet and profit and loss account.

Spain

There is not yet an adequate basis on which to evaluate the practical application as the legislation has only recently be implemented.

United Kingdom

Disclosure follows the legal requirements and SSAP 20.

Annex II

Overview

This overview of requirements should be read in connection with the annex "Legal and other Requirements on Foreign Currency Translation".

ANNUAL ACCOUNTS	**Yes**	**No**	**Yes with a few exceptions**
All foreign currency monetary items are translated at closing rate	BELGIUM FRANCE ITALY LUXEMBOURG NETHERLANDS PORTUGAL SPAIN	GERMANY LUXEMBOURG (most common practice)	DENMARK GREECE IRELAND LUXEMBOURG UNITED KINGDOM (hedging rate where appropriate)
	Fully recognised	**Deferred**	**Not recognised**
Positive translation differences a) treatment	DENMARK IRELAND LUXEMBOURG NETHERLANDS PORTUGAL UNITED KINGDOM	BELGIUM FRANCE GREECE LUXEMBOURG PORTUGAL SPAIN	GERMANY ITALY LUXEMBOURG (most common practice

	Full set-off	Partly set-off	Not set-off
b) set off against negative translation differences	BELGIUM (if same exchange risk) DENMARK GREECE IRELAND LUXEMBOURG NETHERLANDS SPAIN UNITED KINGDOM	FRANCE (provision) LUXEMBOURG	GERMANY (only in case of hedging) ITALY LUXEMBOURG
	Suspense account	**Deferred income**	**N/A**
c) if deferred, heading in balance sheet	BELGIUM (translation differences) FRANCE (écart de conversion) LUXEMBOURG	GREECE SPAIN (Income deferred over various periods)	DENMARK GERMANY IRELAND NETHERLANDS UNITED KINGDOM
Distinction in treatment between translation differences on long term and short term foreign currency monetary items	ITALY LUXEMBOURG (most common practice) PORTUGAL	BELGIUM DENMARK LUXEMBOURG	FRANCE GERMANY GREECE IRELAND NETHERLANDS SPAIN UNITED KINGDOM

CONSOLIDATED ACCOUNTS	Yes	No	N/A
Distinction made between integrated and non-integrated foreign branches and subsidiaries	DENMARK FRANCE (Implicitly) IRELAND NETHERLANDS SPAIN UNITED KINGDOM	BELGIUM GERMANY GREECE ITALY LUXEMBOURG	
	Yes	**No**	**N/A**
Monetary items financing investments in affiliated companies are treated differently	DENMARK GERMANY IRELAND NETHERLANDS UNITED KINGDOM	GREECE ITALY LUXEMBOURG SPAIN	BELGIUM FRANCE
	Closing rate method	**Closing rate/Net Investment method**	**Temporal method**
Translation method of annual accounts of foreign operations to be included in the consolidated accounts	BELGIUM FRANCE GERMANY GREECE ITALY (* *) LUXEMBOURG ((* *) NETHERLANDS	DENMARK FRANCE GERMANY IRELAND ITALY (* *) LUXEMBOURG (* *) NETHERLANDS SPAIN UNITED KINGDOM	BELGIUM DENMARK FRANCE (*) GERMANY GREECE IRELAND (*) LUXEMBOURG (* *) NETHERLANDS SPAIN (*) UNITED KINGDOM (*)

* Integrated branches and subsidiaries

* *Practice, no requirement

	Closing rate	Average rate	Transaction rate
Exchange rate at which profit and loss account of the annual accounts of foreign operations is included in the consolidated accounts	FRANCE GERMANY IRELAND LUXEMBOURG (*) NETHERLANDS UNITED KINGDOM	BELGIUM FRANCE GERMANY GREECE IRELAND ITALY (*) LUXEMBOURG (*) NETHERLANDS SPAIN UNITED KINGDOM DENMARK (**)	BELGIUM DENMARK GERMANY IRELAND SPAIN UNITED KINGDOM

* Practice, no requirement
** As an exception

	Charged to equity	Charged to P & L	Deferred
In case of average rate. treatment of resulting translation difference	DENMARK (* *) FRANCE GREECE IRELAND LUXEMBOURG SPAIN NETHERLANDS UNITED KINGDOM	DENMARK (*) GERMANY (provision) NETHERLANDS	BELGIUM (***)

* Integrated branches and subsidiaries

* * for Denmark, also in case of transaction rate

*** Different rules may apply provided that the choice satisfies objective criteria

European Commission

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