SSAP 11
STATEMENT OF STANDARD ACCOUNTING PRACTICE 11
FOREIGN CURRENCY TRANSLATION

(Issued February 1985; revised July 1986 and December 2001)

The provisions of this statement of standard accounting practice should be read in conjunction with the Explanatory Foreword to accounting standards and need not be applied to immaterial items.

Part 1 - Introduction

Background

1. A company may engage in foreign currency operations in two main ways:

   a. It may enter directly into business transactions which are denominated in foreign currencies. The results of these transactions will need to be translated into the currency in which the company reports.

   b. Foreign operations may be conducted through a foreign enterprise which maintains its accounting records in a currency other than that of the investing company. In order to prepare consolidated financial statements it will be necessary to translate the complete financial statements of the foreign enterprise into the currency used for reporting purposes by the investing company.

Objectives of translation

2. The translation of foreign currency transactions and financial statements should produce results which are generally compatible with the effects of rate changes on a company's cash flows and its equity and should ensure that the financial statements present a true and fair view of the results of management actions. Consolidated statements should reflect the financial results and relationships as measured in the foreign currency financial statements prior to translation.

Procedures

3. In this Statement the procedures which should be adopted when accounting for foreign operations are considered in two stages, namely:

   a. the preparation of the financial statements of an individual company; and

   b. the preparation of consolidated financial statements.

Part 2 - Definition of Terms

4. *Financial statements* are balance sheets, profit and loss accounts (income statements), ~~statements of changes in financial position~~cash flow statements, statements of changes in equity andnotes ~~and other statements~~ which collectively are intended to give a true and fair view of the financial position and profit or loss.

5. *Company* includes any enterprise which comes within the scope of statements of standard accounting practice.

6. A *foreign enterprise* is a subsidiary, associated company or branch whose operations are based in a country other than that of the investing company or whose assets and liabilities are denominated mainly in a foreign currency.

7. A *foreign currency asset* is an equity investment or other long-term non-monetary asset, the holding or the use or the subsequent disposal of which will generate receipts in a foreign currency.

8. *Translation* is the process whereby financial data denominated in one currency are expressed in terms of another currency. It includes both the expression of individual transactions in terms of another currency and the expression of a complete set of financial statements prepared in one currency in terms of another currency.

9. *The temporal method of translation requires* translation of all assets, liabilities, revenue and expenses at the exchange rate ruling at the date on which the amount recorded in the financial statements was established. At the balance sheet date monetary assets and liabilities are retranslated at the closing rate and any resulting exchange difference is taken to the profit and loss account.

10. An *exchange rate* is a rate at which two currencies may be exchanged for each other at a particular point in time; different rates apply for spot and forward transactions.

11. The *closing rate* is the exchange rate for spot transactions ruling at the balance sheet date and is the mean of the buying and selling rates at the close of business on the day for which the rate is to be ascertained.

12. A *forward contract* is an agreement to exchange different currencies at a specified future date and at a specified rate. A non-speculative forward contract is one which is designated and effective as a hedge of a net investment in a foreign entity, of a foreign currency asset, of a net monetary asset or liability or of a firm commitment. All other forward contracts, or parts of forward contracts in excess of the amount hedged, are speculative.

13. *The gain or loss on a non-speculative forward contract* is the foreign currency amount of the contract multiplied by the difference between the spot rate at the balance sheet date and the spot rate at the date of inception of the contract or at an intervening balance sheet date.

14. *The discount or premium on a non-speculative forward contract* is the foreign currency amount of the contract multiplied by the difference between the contracted forward rate and the spot rate at the date of inception of the contract.

15. *The gain or loss on a speculative forward contract* is the foreign currency amount of the contract multiplied by the difference between the forward rate for the balance of the contract at the balance sheet date and either the contracted forward rate or the forward rate used at an intervening balance sheet date.

16. *The net investment* which a company has in a foreign enterprise is its effective equity stake and comprises its proportion of such foreign enterprise's net assets; in certain circumstances, intra-group loans and other deferred balances may be regarded as part of the effective equity stake.

17. *Monetary items* are money held and amounts to be received or paid in money.

Part 3 - Standard Accounting Practice

18. When preparing the financial statements of an individual company the procedures set out in paragraphs 19 to 28 should be followed. When preparing consolidated financial statements the procedures set out in paragraphs 29 to 34 should be followed.

Individual companies

19. Subject to the provisions of paragraphs 21 and 25 each asset, liability, revenue or cost arising from a transaction denominated in a foreign currency should be translated into the reporting 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.

20. Subject to the special provisions of paragraph 25, which relate to the treatment of foreign currency assets financed by foreign currency borrowings or hedged by forward contracts, no subsequent translations should normally be made once non-monetary assets have been translated and recorded.

21. At each balance sheet date monetary assets and liabilities denominated in a foreign currency should be translated using the closing rate or, where appropriate, the rates of exchange fixed under the terms of the relevant transactions.

22. An exchange gain or loss will result during an accounting period if a business transaction is settled at an exchange rate which differs from that used when the transaction was initially recorded or, where appropriate, that used at the last balance sheet date. An exchange gain or loss will also arise on unsettled transactions if the rate of exchange used at the balance sheet date differs from that used previously. Such exchange gains and losses should be included in the profit or loss from ordinary activities unless they arise from events which themselves fall to be treated as extra-ordinary items, in which case they should be included as part of such items.

23. Where exchange gains arise on monetary items and there are, exceptionally, doubts as to the convertibility or marketability of the currency in question, it is necessary to consider on the grounds of prudence whether 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.

24. Gains or losses on exchange arising from transactions between a holding company and its subsidiaries, or from transactions between fellow subsidiaries, should normally be reported in the individual company's financial statements as part of the profit or loss for the year in the same way as gains or losses arising from transactions with third parties.

25. Where a company has used foreign currency borrowings or forward contracts to finance, or provide a hedge against, its foreign currency assets and the conditions set out in this paragraph apply, the foreign currency assets should 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 company's financial statements. Any exchange differences arising should be taken to reserves and the exchange gains or losses arising on the borrowings or the forward contracts should then be offset, as a reserve movement, against those exchange differences. The conditions which must apply are as follows:

a. in any accounting period exchange gains or losses arising on the borrowings or the forward contracts should be offset only to the extent of exchange differences arising on the foreign currency assets; and

b. the foreign currency borrowings or the forward contracts are designated and effective as a hedge against the foreign currency assets.

Where a forward contract is used as a hedge of a foreign currency asset, the discount or premium on the contract should be either amortised in the profit and loss account over the period of the contract or taken to reserves with the gain or loss.

Forward contracts

26. Where a non-speculative forward contract is used as a hedge of a net monetary asset or liability the gain or loss on the contract should be taken to the profit and loss account and the discount or premium may be either amortised over the period of the contract or taken to the profit and loss account.

27. Where a non-speculative forward contract is used as a hedge of a firm commitment no gain or loss need normally be recognised during the commitment period. At the end of that period any gain or loss will be added to, or deducted from, the amount of the relevant transaction. The discount or premium should be either amortised over the period of the contract or deferred with the gain or loss.

28. Where a forward contract is speculative the gain or loss should be credited or charged to the profit and loss account.

Consolidated financial statements

29. When preparing group accounts for an investing company and its foreign enterprises the ~~closing rate/~~net investment method of translating the financial statements should normally be used. Under this method the amounts in the balance sheet of a foreign enterprise should be translated into the investing company's reporting currency using the closing rate of exchange. Exchange differences will arise if this rate differs from that ruling at the previous balance sheet date or at the date of any subsequent capital injection (or reduction) and these differences should be recorded as a movement on reserves.

30. The profit and loss account of a foreign enterprise accounted for under ~~the closing rate/~~ net investment method should be translated ~~either 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; the use of a weighting procedure will in most cases be desirable.

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

32. 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.

33. Where foreign currency borrowings or forward contracts have been used to finance, or provide a hedge against, group net investments in foreign enterprises, exchange gains or losses on the borrowings or forward contracts, which would otherwise have been taken to the profit and loss account, should be offset as reserve movements against exchange differences arising on the retranslation 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~~ net investment method for consolidation purposes;

b. in any accounting period the exchange gains and losses arising on the foreign currency borrowings or forward contracts are offset only to the extent of the exchange differences arising on the net investments in foreign enterprises; and

c. the foreign currency borrowings or forward contracts are designated and effective as a hedge against the net investments.

Where a forward contract is used as a hedge of a net investment, the discount or premium on the contract should be either amortised in the profit and loss account over the period of the contract or taken to reserves with the gain or loss.

34. Although equity investments in foreign enterprises will normally be made by the purchase of shares, investments may also be made by means of long-term loans and intra-group deferred trading balances. Where financing by such means is intended to be, for all practical purposes, as permanent as equity, such loans and intra-group balances should be treated as part of the investing company's net investment in the foreign enterprise. Hence exchange differences arising on such loans and intra-group balances should be dealt with as adjustments to reserves.

Disclosure

35. 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.

36. The following information should also be disclosed in the financial statements of all companies other than licensed banking, insurance and shipping companies which take advantage of the disclosure exemptions permitted under Part III of the Tenth Schedule to the Companies Ordinance:

a. the net amount of exchange gains and losses on foreign currency borrowings less deposits, identifying separately:

i. the amount offset in reserves under the provisions of paragraphs 25 and 33; and

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

b. the net amount of exchange gains or losses on forward contracts, together with any associated discount or premium on these contracts, offset in reserves under the provisions of paragraphs 25 and 33; and

c. the net movement on reserves arising from exchange differences.

Transitional arrangements

37. Where the provisions of this Statement are applied to the translation of foreign currency operations for the first time it may represent a change in accounting policy which will normally need to be reflected as a prior year adjustment to the opening balance of retained profits in accordance with Statement 2.102 (SSAP 2). Alternatively, where the calculation of a prior year adjustment is impractical the changes in policy may be applied only to current and future financial statements provided that the effect on the results of the current period is disclosed.

Date from which effective

38. Except for paragraphs 29, 30 and 33, the~~The~~ accounting and disclosure requirements set out in this statement ~~should be adopted as soon as possible. They~~ should be regarded as standard in respect of financial statements relating to accounting periods beginning on or after 1st January 1985. Paragraphs 29, 30 and 33 should be regarded as standard in respect of financial statements relating to accounting periods beginning on or after 1 January 2002.

Part 4 - Legal Requirements in Hong Kong

39. Paragraph 12(14) of the Tenth Schedule to the Companies Ordinance requires the following matter to be shown by way of note to the balance sheet: "the basis on which other currencies have been converted into the currency in which the balance sheet is expressed, where the amount of the assets or liabilities affected is material".

Part 5 - Compliance with International Accounting Standards

40. The requirements of International Accounting Standard No. 21 "Accounting for the effects of changes in foreign exchange rates" accord very closely with the content of this Statement. Accordingly compliance with this Statement will ensure compliance with IAS 21 in all material respects.

Part 6 - Explanatory Note

This explanatory note is for general guidance only and does not form part of the statement of standard accounting practice.

41. The method used to translate financial statements for consolidation purposes should reflect the financial and other operational relationships which exist between an investing company and its foreign enterprises.

42. In most circumstances the ~~closing rate/~~net investment method should be used. This method recognises that the investment of a company is in the net worth of its foreign enterprise rather than a direct investment in the individual assets and liabilities of that enterprise. The foreign enterprise will normally have net current assets and fixed assets which may be financed partly by borrowings in its own reporting currency. In its day-to-day operations the foreign enterprise is not normally dependent on the reporting currency of the investing company. The investing company may look forward to a stream of dividends but the net investment will remain until the business is liquidated or the investment disposed of.

43. Exceptionally, however, there are cases in which the affairs of a foreign enterprise are so closely interlinked with those of the investing company that its results may be regarded as being more dependent on the economic environment of the investing company's currency than on that of its own reporting currency. In such a case the financial statements of the foreign enterprise should be included in the consolidated financial statements as if all its transactions had been entered into by the investing company itself in its own currency. For this purpose the temporal method of translation should be used.

44. It is not possible to select one factor which of itself will lead a company to conclude that the temporal method should be adopted. All the available evidence should be considered in determining whether the currency of the investing company is the dominant currency in the economic environment in which the foreign enterprise operates. Amongst the factors to be taken into account will be:

    a. the extent to which the cash flows of the enterprise have a direct impact upon those of the investing company;

    b. the extent to which the functioning of the enterprise is dependent directly upon the investing company;

    c. the currency in which the majority of the trading transactions are denominated;

    d. the major currency to which the operation is exposed in its financing structure.

45. Examples of situations where the temporal method may be appropriate are where the foreign enterprise:

a. acts as a selling agency receiving stocks of goods from the investing company and remitting the proceeds back to that company;

b. produces a raw material or manufactures parts or sub-assemblies which are then shipped to the investing company for inclusion in its own products;

c. is located overseas for tax or legal reasons to act as a means of raising finance for other companies in the group.

46. For the purposes of this Statement foreign operations which are conducted through a foreign branch should be accounted for in accordance with the nature of the business operations concerned. Where such a branch operates as a separate business with local finance it will be accounted for using the ~~closing rate/~~net investment method. Where the foreign branch operates as an extension of the company's trade and its cash flows have a direct impact upon those of the company the temporal method will be appropriate.