

**TOPIC 1.8: ACCOUNTING FOR FOREIGN EXCHANGE TRANSACTIONS**

This section of the manual sets out the FSOP's that need to be executed by the municipality regarding the management of foreign exchange transactions. The FSOP's are drafted in the following categories:

- 1.8.1 Overview of the accounting for foreign exchange transactions**
- 1.8.2 Introduction**
- 1.8.3 Accounting procedures for transactions in foreign exchange**
- 1.8.4 AFS disclosure requirements**
- 1.8.5 Exemptions related to the implementation of GAMAP 4**
- 1.8.6 Comparison between GAMAP 4 and GRAP 4**

### 1.8.1 OVERVIEW OF THE ACCOUNTING FOR FOREIGN EXCHANGE TRANSACTIONS

When accounting for foreign exchange transactions the municipality must ensure that the necessary finance standard operating procedures are executed to address the following issues, which are summarised here, but for which the detailed FSOP's are set out in the rest of this section.

Category	Section FSOP
<b>Introduction.</b> In order to include foreign currency transactions in the financial statements of a municipality, transactions must be expressed in its reporting currency, as per the relevant standard on accounting for foreign exchange transactions.	Section 1.8.2
<b>In accounting for foreign exchange transactions,</b> the municipality must ensure that all foreign currency transactions are recorded on <b>initial recognition</b> in the reporting currency of the municipality (i.e. Rand). At subsequent reporting dates, <b>foreign currency monetary items</b> are <b>restated</b> at the exchange rate at the <b>reporting date</b> , while <b>non-monetary items</b> which are <b>carried</b> in terms of <b>historical cost</b> denominated in a foreign currency are <b>not restated</b> to the exchange rate at the reporting date.	Section 1.8.3
The municipality must ensure that <b>disclosure requirements for foreign exchange transactions</b> in accordance with GAMAP 4 are met.	Section 1.8.4
<b>Exemptions related to the implementation of GAMAP 4.</b> No exemptions from the requirements of GAMAP 4 have been offered by NT to high capacity municipalities (HCM), medium capacity municipalities (MCM) and low capacity municipalities (LCM), preparing GRAP AFS.	Section 1.8.5
<p><b>EXEMPTIONS – 30 JUNE 2008</b></p> <ul style="list-style-type: none"> <li>➤ MCM and LCM can prepare IMFO AFS for 2008, and therefore ignore GAMAP 4 in totality, but if they prepare GRAP AFS the entire standard should be complied with.</li> </ul> <p><b>EXEMPTIONS – 30 JUNE 2009</b></p> <ul style="list-style-type: none"> <li>➤ LCM can prepare IMFO AFS for 2009 and therefore ignore GRAP 4 and GAMAP 4 in totality. If however the LCM opts to prepare GRAP AFS for 30 June 2009, it must comply with all the requirements of <b>GRAP 4</b> on the effects of changes in the foreign exchange rates.</li> </ul>	
<b>GAMAP 4 and GRAP 4 are compared,</b> and any differences set out in this section.	Section 1.8.4

### 1.8.2 INTRODUCTION

A municipality may have transactions in foreign currencies. In order to include foreign currency transactions in the financial statements of a municipality, transactions must be expressed in its reporting currency.

The principal issues in accounting for foreign currency transactions are to decide which exchange rate to use and how to recognise the financial effect of changes in exchange rates in the financial statements.

	<p><b>Foreign currency</b> is a currency other than the functional currency of a municipality.</p> <p><b>Reporting currency</b> is the currency used in presenting the financial statements.</p> <p><b>Exchange rate</b> is the ratio for exchange of two currencies.</p> <p><b>Exchange difference</b> is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.</p> <p><b>Monetary items</b> are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.</p> <p><b>Transaction date</b> is the date upon which the entity is irrevocably committed to the transaction.</p>
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## 1.8.3 ACCOUNTING PROCEDURES FOR TRANSACTIONS IN FOREIGN EXCHANGE

## a) Initial recognition of foreign currency transactions

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	<p>According to <b>GRAP 4.21</b> (previously <b>GAMAP 4.04</b>) a foreign currency transaction is a transaction which is <b>denominated in or requires settlement in a foreign currency</b>, including transactions arising when an entity either:</p> <ul style="list-style-type: none"> <li>(a) buys or sells goods or services of which the price is denominated in a foreign currency,</li> <li>(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency,</li> <li>(c) becomes a party to an unperformed foreign exchange contract, or</li> <li>(d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.</li> </ul>	Ensure that all <b>foreign currency transactions are recorded</b> , on initial recognition, in the reporting currency of the municipality (i.e. Rand), by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.	AP	CFO	Date of the foreign exchange transaction

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	<p>Most municipalities will <b>probably not</b> become party to transactions outlined in (b), (c) and (d) above.</p> <p>If municipalities are involved in foreign exchange transactions it is highly likely that the nature of the transactions will be where the municipality buys goods of which the price is denominated in a foreign currency as set out in (a) above.</p> <p>According to <b>GRAP 4.21</b> (previously <b>GAMAP 4.05</b>), the spot rate (exchange rate between the reporting currency and the foreign currency at the date of the transaction) is applied to the foreign currency amount to record a foreign currency transaction on initial recognition in the reporting currency (Rand).</p>				

## b) Reporting of foreign currency transactions at subsequent reporting dates

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	<p>According to <b>GRAP 4.25</b> (previously <b>GAMAP 4.07</b>) at each reporting date:</p> <ul style="list-style-type: none"> <li>(a) <b>foreign currency monetary items</b> shall be reported using the closing rate,</li> <li>(b) <b>non-monetary items</b> which are <b>carried</b> in terms of <b>historical cost</b> denominated in a foreign currency shall be reported using the exchange rate at the date of the transaction, and</li> <li>(c) <b>non-monetary items</b> which are <b>carried</b> at <b>fair value</b> denominated in a foreign currency shall be reported using the exchange rates that existed when the values were determined.</li> </ul>	<p>Ensure that all <b>foreign currency monetary items</b> are <b>restated</b> at the exchange rate at the <b>reporting date</b>.</p> <p>An example of a <b>foreign currency monetary item</b> is a trade payable (trade creditor). This creditor therefore needs to be restated at the exchange rate at the reporting date (30 June).</p> <p>(Refer to the <b>Annexure - examples 1 and 2</b> below for an illustration of the accounting journals for such restatement).</p>	AP	CFO	30 June each year
2	An example of a <b>non-monetary item denominated in foreign currency</b> and carried at historical cost is PPE. The PPE will be carried	Ensure that all <b>non-monetary items</b> which are <b>carried</b> in terms of <b>historical cost</b> denominated in a foreign currency are reported using the exchange rate at the date of the transaction, i.e. that these items are <b>not</b> restated to	AP	CFO	30 June each year

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
	at the exchange rate at the date of the transaction and <b>will not</b> be restated to the exchange rate at the reporting date (30 June).	the exchange rate at the reporting date. (Refer to the <b>Annexure – examples 1 and 2</b> below for an illustration of the accounting journals for such a transaction).			
3	It is <b>highly unlikely</b> that a municipality will be party to a transaction involving a <b>non-monetary item</b> which is <b>carried at fair value</b> and denominated in a foreign currency. An example of this type of transaction is an investment in an investment property or in ordinary shares and convertible preference shares and debentures.	Ensure that all <b>non-monetary items</b> which are <b>carried at fair value</b> denominated in a foreign currency are reported using the exchange rates that existed when the values were determined, i.e. the exchange rates that had been used at the latest valuation.	AP	CFO	30 June each year

## c) Recognition of exchange differences

#	FMBPR	FSOP	FSOP Type	Responsible Official	Date of Execution of FSOP
1	According to <b>GRAP 4.30</b> (previously <b>GAMAP 4.10</b> ) exchange differences arising on the settlement of monetary items or on reporting an entity's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, shall be recognised as revenue or as expenses in the period in which they arise.	<p>Ensure that exchange differences arising on the settlement of monetary items or on reporting an entity's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements are <b>recognized as revenue or as expenses in the period in which they arise</b>.</p> <p>(Refer to the <b>Annexure - examples 1 and 2</b> below for an illustration of the accounting journals for such a transaction).</p>	AP	CFO	Settlement date or 30 June each year

#### **1.8.4 AFS DISCLOSURE REQUIREMENTS**

According to **GAMAP 4.15**, the following should be disclosed by the municipality in the AFS:

- (a) The amount of exchange differences included in the surplus or deficit for the period, distinguishing between those arising from borrowing and operating activities, and
- (b) The amount of exchange differences arising during the period which is included in the carrying amount of an asset in accordance with the allowed alternative treatment in **GAMAP 4.13** as discussed in section 1.8.2 c) above.

#### **1.8.5 EXEMPTIONS RELATED TO THE IMPLEMENTATION OF GAMAP 4**

Refer to section 1.8.1 Overview of the accounting for foreign exchange transactions, for a discussion on the exemptions related to the implementation of GAMAP 4.

From 1 July 2008 (reporting date 30 June 2009) **GRAP 4, on the effects of changes in foreign exchange rates**, becomes effective for High capacity and Medium capacity municipalities, while for Low capacity municipalities it becomes effective from 1 July 2009 (reporting date 30 June 2010).

The **transitional provisions** of GRAP 4 states that all changes resulting from the application of the Standard of GRAP on The Effects of Changes in Foreign Exchange Transactions shall be accounted for in accordance with the requirements of the Standard of GRAP on Accounting Policies, Changes in Accounting Estimates and Errors (therefore **retrospectively**).

### 1.8.5 COMPARISON BETWEEN GAMAP 4 AND GRAP 4

In accounting for transactions in **foreign currencies**, the recognition and measurement principles in GAMAP 4 and GRAP 4 do not differ or result in material differences in items presented and disclosed in the financial statements. The **scope** of GRAP 4 is however wider than that of GAMAP 4.

GAMAP 4 only provided guidance on accounting for transactions in foreign currencies, whereas GRAP 4 provides guidance on:

- (a) accounting for **transactions in foreign currencies**,
- (b) **translation of financial statements of a foreign entity**, and
- (c) **translation of an entity's own financial statements into a presentation currency other than its functional currency**.

The following other differences between GAMAP 4 and GRAP 4 exist:

- Definitions of 'closing rate, economic entity, foreign operation, functional currency, and net investment in foreign operation' have been included in GRAP 4 as the definitions are relevant to the understanding of the standard.
- Differences in the definition of 'transaction date' may result in the earlier or later recognition of a transaction on initial adoption of GRAP 4.
- GRAP 4 does not contain the allowed alternative treatment paragraphs as in GAMAP 4.
- Disclosure in GRAP 4 now requires:
  - (a) the amount of exchange differences recognised in surplus or deficit except for those arising on financial instruments measured at fair value through surplus or deficit in accordance with the Standards of GRAP on Financial Instruments; and
  - (b) net exchange differences classified in a separate component of net assets and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
- Additional disclosure requirements of GRAP 4 (para 60-64) was not in GAMAP 4, as the extended scope of GRAP 4 now also include translation of financial statements of a foreign entity, and translation of an entity's own financial statements into a presentation currency other than its functional currency. **This will however not be applicable to South African municipalities**, as municipalities will never be required to translate financial statements of a foreign entity or to translate its own financial statements into a presentation currency other than its functional currency.

**ANNEXURE 1 – Illustrative examples****Example: Purchase of inventories from a foreign supplier**

	SA Municipality purchases inventories from a US supplier. The cost price of the inventories was \$ 200 000 on 1 April 2008, when the exchange rate was \$ 1 = R7. The supplier will be paid on 31 July 2008. No forward cover was taken for the transaction. The exchange rates were as follows:
30 June 2008	\$ 1 = R 7.25
31 July 2008	\$ 1 = R 6.80

The journal entries relating to the above information are as follows:

Date	Description	Debit	Credit
	<b>Transactions for the year ended 30 June 2008</b>		
01/04/08	Inventories	1 400 000	
	Creditors		1 400 000
	Purchase of inventories on 1 April 2008		
30/06/08	Exchange loss	50 000	
	Creditors		50 000
	Restatement of creditor at closing exchange rate on 30/06/08		
	<i>Creditor at reporting date:</i> $R7.25 \times \$200\ 000 = R1\ 450\ 000$ $R1\ 450\ 000 - R1\ 400\ 000 = R50\ 000$ Exchange loss		
	<b>Transactions for the year ended 30 June 2009</b>		
31/07/08	Creditors	1 450 000	
	Exchange gain		90 000
	Bank		1 360 000
	Payment of foreign creditor and realisation of foreign exchange gain		
	<i>Creditor at settlement date:</i> $R6.80 \times \$200\ 000 = R1\ 360\ 000$ $R1\ 450\ 000 - R1\ 360\ 000 = R90\ 000$ Exchange gain		

**Note:** The **exchange loss** of R 50 000 is recognized as a loss in the Statement of Financial Performance for the year ended 30 June 2008. The **exchange gain** of R 90 000 is recognised as a gain in the Statement of Financial Performance for the year ended 30 June 2009.

The **non-monetary item** (Inventories) is **not restated at the reporting date**, but reported using the exchange rate at the date of the transaction, i.e. R7 x \$200 000 = R 1 400 000.

**Example 2: Purchase of PPE from a foreign supplier**

	SA Municipality purchases a fire truck from a US supplier. The cost price of the truck was \$ 200 000 on 1 April 2008, when the exchange rate was \$ 1 = R7. The supplier will be paid on 31 July 2008. No forward cover was taken for the transaction. The exchange rates were as follows:
30 June 2008	\$ 1 = R 7.25
31 July 2008	\$ 1 = R 6.80

The journal entries relating to the above information are as follows:

Date	Description	Debit	Credit
	<b>Transactions for the year ended 30 June 2008</b>		
01/04/08	PPE: Vehicles	1 400 000	
	Creditors		1 400 000
	Purchase of fire truck on 1 April 2008		
30/06/08	Exchange loss	50 000	
	Creditors		50 000
	Restatement of creditor at closing exchange rate on 30/06/08		
	<i>Creditor at reporting date: R7.25 x \$200 000 = R1 450 000 R1 450 000 – R1 400 000 = R50 000 Exchange loss</i>		
30/06/08	Depreciation	22 500	
	Accumulated depreciation: Vehicles		22 500
	Depreciation for the year		
	<i>Truck depreciated over 15 years: R1 400 000 – R50 000 residual = R1 350 000 R1 350 000/15 = R90 000 per year x 3/12 (3 months of 2007/08 financial period) = R22 500</i>		
	<b>Transactions for the year ended 30 June 2009</b>		
31/07/08	Creditors	1 450 000	
	Exchange gain		90 000
	Bank		1 360 000
	Payment of foreign creditor and realisation of foreign exchange gain		

Date	Description	Debit	Credit
	<i>Creditor at settlement date:</i> $R6.80 \times \$200\,000 = R1\,360\,000$ $R1\,450\,000 - R1\,360\,000 = R90\,000$ Exchange gain		
30/06/09	Depreciation	90 000	
	Accumulated depreciation: Vehicles		90 000
	Depreciation for the year		
	<i>Truck depreciated over 15 years:</i> $R1\,400\,000 - R50\,000$ residual = $R1\,350\,000$ $R1\,350\,000/15 = R90\,000$ per year		

**Note:** The **exchange loss** of R 50 000 is recognized as a loss in the Statement of Financial Performance for the year ended 30 June 2008. The **exchange gain** of R 90 000 is recognised as a gain in the Statement of Financial Performance for the year ended 30 June 2009.

The **non-monetary item** (PPE) is **not restated at the reporting date**, but reported using the exchange rate at the date of the transaction, i.e.  $R7 \times \$200\,000 = R\,1\,400\,000$ .