**FOREIGN BRANCH**

A foreign branch is an independent branch of a business organisation located in a country other than the one in which the head office is located. The standard applicable in order to establish a proper basis for reporting the financial results of a foreign branch in naira (N) is IAS 21 (*The effects of changes in foreign exchange rates*).

**Definition of Terms**

1. **Foreign Currency**: any currency other than the domestic currency, the naira.
2. **Conversion**: This is the process of expressing a foreign currency amount in naira by the use of an appropriate rate of exchange. The need for this arises as a result of transferred goods and cash movements between the Head Office and the foreign branch.
3. **Translation:** this is the restating of accounting balances of foreign operations at their equivalents in Naira. This usually concerns the items appearing on the trial balance of the branch, which are not results of transactions between the head office and the branch.
4. **Exchange Rate:** this is the rate at which the currency of a country is exchanged for the currency of another country. Some of the common exchange rates in practice include the following:
5. **Official Exchange Rate:** this is the rate that is established by the appropriate government agency for eligible transactions.
6. **Spot Rate:** this is the exchange rate prevailing on a particular day.
7. **Closing** **Rate:** this is the exchange rate ruling at the statement of financial position date.
8. **Forward Rate:** this is the rate quoted or agreed upon now for future delivery of currency between the parties involved.
9. **Reporting Currency:** this is the currency in which financial transactions are recorded and financial statements are presented. The Naira is the reporting currency for any Nigerian business enterprise.
10. **Foreign Operations:** this refers to the business activities, based in a country other than Nigeria, of a branch, subsidiary, associate or joint venture of a Nigerian enterprise.
11. **Foreign Entity:** a foreign entity exists where the activities of a branch, subsidiary, associate or joint venture do not form an integral part of the activities of the related enterprise in Nigeria. According to IAS 21, the indications that a foreign operation is a foreign entity include the following:
12. The activities of the foreign operation are carried out with a significant degree of autonomy from the activities of the reporting enterprise, even while the reporting enterprise has control over the foreign operation;
13. Transactions with the reporting enterprise do not constitute a high proportion of the activities of the foreign operation;
14. The activities of the foreign operation are financed mainly from its own operation or local borrowings, rather than from the reporting enterprise;
15. The foreign operation’s sales are mainly in currencies other than the reporting currency.
16. **Monetary Items:** these are monies held and items to be received or paid in money. All other assets and liabilities are non-monetary items.
17. **Foreign Currency Loan:** this is an obligation repayable in foreign currency.
18. **Hedging:** this is the reduction or elimination of the risk of loss arising from fluctuations in the exchange rate. It helps ensure a high degree of certainty with respect to amount receivable or payable at a later date in a foreign exchange transaction irrespective of adverse fluctuations in the exchange rate. One way of hedging is to fix a forward rate for the transaction in question.

**FOREIGN CURRENCY CONVERSIONS**

Where a Nigerian business organisation exports goods or render services to a foreign company, the bill may be made out in naira or a foreign currency. If the bill is in naira, and the foreign company pays the bill in naira, the transaction is treated like any other normal domestic transaction.

Where the foreign company is billed in a foreign currency, the payment when received may be lodged into a foreign currency domiciliary account or sold to an authorised dealer. In both cases, the payment is converted to naira at the exchange rate ruling at the date of receipt.

If the exchange rate at the date of the receipt of payment is the same as it was at the date of sale, no exchange gain or loss has occurred. If, however, the rates at these dates are not the same, an exchange gain or loss has occurred and it has to be recognised in the statement of profit or loss.

If a Nigerian enterprise imports goods or receives services from a foreign company and the bill is made out in naira, the transaction is treated as though it was a domestic transaction.

At the Statement of Financial Position date, the differences which arise on conversion of accounts’ balances are written off to the Statement of profit or loss except differences on long term foreign currency monetary items. In this case the difference may be deferred and written off over the rest of the lives of the monetary items concerned. If the difference is a loss, it is not usually deferred if there is reason to expect that exchange loss will recur on the monetary item(s) concerned in future.

**TRANSLATION OF ACCOUNT BALANCES**

The trial balance of a foreign operation will be dominated in foreign currency. If these balances are to be incorporated into the financial statements of the Nigerian parent enterprise, they have to be translated to naira. The 3 main methods of translating foreign currency accounts’ balances are as follows:

1. **Closing Rate Method**

Under this method, all assets and liabilities are translated at the rate ruling at the Statement of Financial Position date. It is also referred to as the Current Rate Method. This method is basically used where the foreign operation is a foreign entity. The translation of various trail balance items will be done as follows:

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| --- | --- |
| **Item** | **Exchange Rate for Translation** |
| Assets and Liabilities (monetary and non-monetary) | Closing Rate |
| Statement of Profit or Loss (Income Statement) items | Rate ruling at the date of transactions or average rate. |

1. **Temporal Method**

Under this method, current assets and liabilities are translated at the statement of financial position date and non-current assets and liabilities are translated at the applicable historical rates at the dates they were acquired or incurred. It is also referred to as the Current-Non-Current method. The method is basically used where the foreign operations is not a foreign entity.

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| **Item** | **Exchange Rate for Translation** |
| Non-current Assets | Rate ruling when the assets were bought |
| Depreciation Charge and Accumulated Depreciation | Rate ruling when the assets were bought |
| Opening Stock | Rate ruling at the previous SOFP date or average rate for the period during which the opening stock was acquired |
| Current Assets (excluding closing stock) and Current Liabilities | Closing Rate |
| Closing Stock | Rate ruling at the present SOFP date or average rate for the period during which the closing stock was acquired |
| Long-term liabilities | Rate ruling at the date the liabilities were incurred |
| Goods from head office | Rate ruling at the dates the goods were sent (i.e. the actual balance on the account at the HO after adjusting for goods in transit) |
| Remittance from/to branch | Rate ruling at the date of remittance (i.e. the actual balance on the account at the HO after adjusting for cash in transit) |
| Statement of Profit or Loss (Income Statement) items excluding depreciation and stocks | Average Rate for the year |
| Head Office Current Account | Actual balance on branch current account in the HO after adjusting for goods in transit |

After the translation, it is usual that the sum of the debit and credit balances are no longer equal. This is due to the fact that different rates of exchange were used in the translation. The balancing figure is an **Exchange Difference:** it is an exchange gainif it is a credit balance and an exchange loss if debit. It is usually written off to the Statement of Profit or Loss/Reserves.

1. **Monetary, Non-Monetary Method**

Under this method, monetary assets and liabilities are translated at the rates ruling at the SOFP date and non-monetary assets and liabilities at the historical rates ruling at the dates they were acquired or incurred. Assets and liabilities are regarded as monetary if their normal values are fixed. All other SOFP items are classified as non-monetary.

**DISCLOSURE REQUIREMENTS**

1. The accounting policy with respect to treatment of foreign exchange conversions and translation.
2. The treatment given to foreign exchange gains and losses.
3. The net total gains or losses arising from changes in foreign exchange rates taken to the statement of profit or loss and other comprehensive income.
4. Restrictions, if any, on repatriation of investments or return thereon to Nigeria.
5. Post Statement of Financial Position rate movements on transactions that have significant impact on the Statement of Profit or Loss and SOFP items should be in notes to the accounts.
6. The amount of gains or losses deferred.