EXCHANGE RATE DIFFERENCES IN FOREIGN TRADE. ACCOUNTANT AND FISCAL TREATMENTS APPLIED IN THE FRAME OF ROMANIA'S ADHESION TO EUROPEAN UNION

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Abstract: The increased globalization degree and the more emphasized complexity of world economy are tightly connected to the increase of economical operations' frequency determined by foreign trade activity. From this point of view, but not only, these operations represent for accountancy an extremely important domain of application. In the same effect, in the process of foreign trade accountancy operations we meet both common elements with the accountancy process of other economical operations determined by domestic commerce, and also a series of difficulties which are connected either to the decision concerning the used exchange rate or to the manner in which the variation effects of exchange rate is kept in accountancy. In the above mentioned frame, this paper holds forth a series of theoretical and practical aspects that are aiming: exchange rate and its settlement by means of different normative documents, exchange rate's variation, exterior trade's structure change after Romania's adhesion to European Union, exchange rate differences specific to various foreign operations and the manner of keeping their accountancy, but as well the consequences of IAS 21 application – *Currency exchange rate's variation effects* on the accountancy of rate differences.

I. Theoretical foundation concerning the currency exchange rate

The currency exchange rate is the expression of value report between two currencies, more precisely, it represents the price of a national or international currency unit expressed by means of another national or international currency. In foreign trade practice the essential role is played by free (market) exchange rate that is established on currency market for the currency that may be converted in the basis of demand and offer.

The exchange rate's variation of a currency represents the exchange price modification of the respective currency unit. This may take place daily according to the influence of some factors connected to monetary, financial, social politics of some states as well as of some factors of psychological nature. The exchange rate's modification may be materialized either in the decrease of a foreign currency value (its depreciation) or in the increase of a foreign currency value (its appreciation), both cases giving birth to currency exchange rate differences.

Currency exchange rate difference is, according to IAS 21, the difference that results from the conversion of a currency's specific number of units in another currency in different exchange rates.

When the quantum of currency exchange rate's differences reaches remarkable sizes the currency risk for some economical agents that attend the economical operations determined by *foreign trade* appears.

II. Currency exchange rate's settlement in Romania

The use of a specific exchange rate, in the frame of external economical operations and of other events determined by these, is settled, in Romania, by means of different normative documents. From this category, we present:

D. Fiscal code, which, for instance, nowadays it settles the use of exchange rate under the following situations:

- Distance sale of some goods from one member state towards Romania on a standard that crosses over 35.000 Euro - exchange rate used for the establishment of the counterpart in lei is the exchange rate settled by BNR in the last working day of the previous year;
- The establishment of a tax basis for goods importation – the quantum establishment in lei of the tax basis that is expressed in foreign currency, needed for VAT calculation, it is made according to the Customs code;
- The establishment of a tax basis for other operations than goods importation - the quantum establishment in lei of the tax basis is made according to the last exchange rate settled by BNR, or on the basis of exchange rate used by the bank by means of which the deduction is realized, from the date when the tax exigibility for the respective operation intervenes;
- At the invoicing, for registration in sales book - exchange rate used for converting in lei the chargeable basis will be the rate recorded in one of the prior mentioned situations;

E. The customs code, settles the exchange rate for operations such as:

- When the elements used for the value's establishment in the customs are expressed in another currency different than the national one - exchange rate used for transformation in lei of that value in the customs is the rate registered in the last but one Wednesday of the month and published in that day. This rate is used during the whole next month, the following cases being exceptions:

i. In the case in which the exchange rate is not registered in the last but one Wednesday of the month, or if, even registered, was not published in that day – the last registered and published rate in the prior 14 days is considered as registered for the respective day of Wednesday;

ii. In the case in which the exchange rate registered in the last Wednesday of one month and published in the same day differs with 5% more than the rates above established , this replaces those starting with the first day of Wednesday of the respective month (the replacing rate remaining to be used for the whole period remained from the current month, only if this rate is not replaced as a conclusion of the fact that in a prior Wednesday the registered and published rate differs with 5% more than the anterior established rate, the replacement of the last one entering in use in the next day of Wednesday);

iii. Under the situation in which the customs authority, at the demand of the person who asks it, accepts to present posterior the event details for putting on free circulation, under the form of a global declaration, the use of a single rate may be established at the converting in lei of the elements used for the value calculation in the customs. This rate is the rate valid in the first day of the period to which the respective customs declaration refers.

F. O.M.F.P. 1752/2005, the normative document by means of which the accountancy settlements according to European directives, contains, in the afferent chapter financial situations, the following stipulations concerning the exchange rate:

- When the initial accountancy rises – an operation expressed in foreign currency must be registered in national currency, by the use of the exchange rate valid on that date when the transaction takes place;
- When the balance sheet rises – the balance sheet elements expressed in foreign currency are treated as follows:

- monetary elements expressed in foreign currency (availabilities and other assimilated elements, as letters of credit, bank deposits, customs debts and duties) must be evaluated and reported using the exchange rate communicated by BNR, valid at the date when the financial exercise is concluded;
- nonmonetary elements purchased with the payment in foreign currency and registered on historic cost – immobilisatios, stocks – must be reported by the use of exchange rate valid at the transaction date's conclusion
- nonmonetary elements purchased with the payment in foreign currency and registered on the fair value must be reported by using the exchange rate valid on the date of the respective value determination.

As what this last stipulation is concerned, between the initial accountancy moment and the moment of deduction, stocktaking (debts and duties resulted from exterior trade operations) as well as the one of conclusion of financial exercise, may occur differences in the exchange rate.

Before establishing which are the types of differences that may occur, we think that a redefinition of exterior trade notion is needed, as a consequence of Romania's adhesion to European Union.

III. Approach on *foreign trade* notion in present context

The approach on *foreign trade* after Romania's adhesion to European Union must be revised. Thus, even though the general acceptation according to *Romania's foreign trade represents the trade unrolled by this one with other states* should be maintained, we can no longer talk about *importation and exportation* as the two basis elements of foreign trade activity.

The Romania's foreign trade structure may be described in the present hereby:

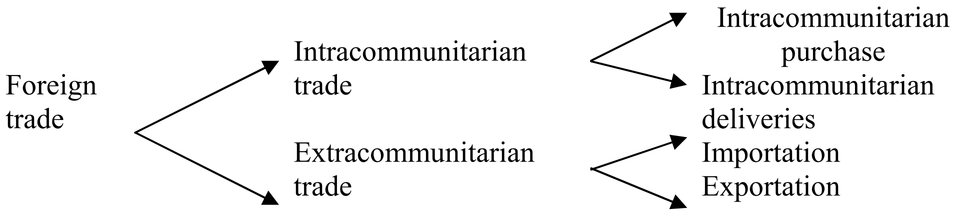

Fig. 1 Basis components of exterior trade

IV. The main types of differences in exchange rate, as well as the result determined by these in firm's accountancy are represented in the figure underneath:

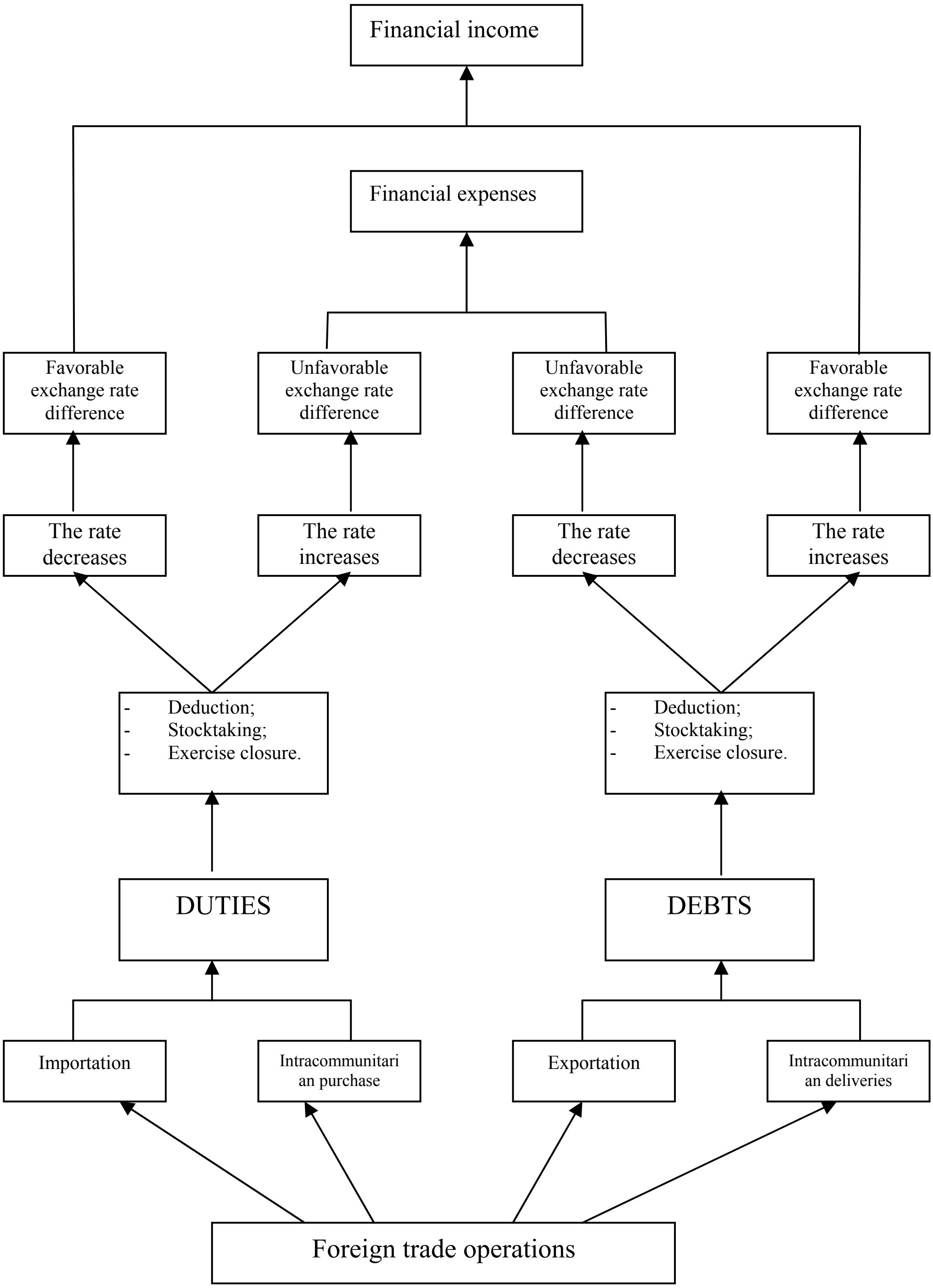

Fig. 2: Apparition of exchange rate differences

V. Exchange rate differences accountancy according to the Romanian settlements

As above mentioned, according to Romanian accountancy settlements, differences in exchange rate may occur in the following situations:

1. At the moment of debts and duties in foreign currency, the rate difference being given by the difference between the *historic rate* (the course valid on the transaction date's conclusion, meaning the one of duty or debt apparition, if the apparition produced during the same financial exercise, or the rate from the conclusion of the anterior exercise, if the apparition occurred, totally or partially, during the anterior exercise) and the rate valid in the deduction moment.

The exchange rate differences resulted in this way will be recognized as in the financial situations as profit or loss during the period when occur. Thus two cases should be submitted under discussion:

Case A: The debt or duty is deducted in the same financial exercise where it appeared – the whole difference is recognized in that exercise

Example: "A" society from Romania deliveries finite products to exterior (Brazil) on the 1st of June N, with a value of 10.000 Euro, the rate on the transaction date being 3,4 lei/euro. The debt's collection takes place on the 1st of November N, on a 3,5 lei/euro rate.

The following operations will be registered:

- the initial recognition of debt:

4111	=	701	34.000 lei

- the debt's deduction and the recognition of the favorable rate difference:

5124	=	%	35.000 lei
		4111	34.000 lei
		765	1.000 lei

Case B: The debt or duty is deducted during a financial exercise posterior the one when it appeared – the difference is recognized in any financial exercise where it intervenes until the moment of deduction and it will de generated taking into consideration the exchange rate modification happened during each exercise.

Example: "A" society from Romania deliveries finite products to exterior (Brazil) on the 1st of June N, with a value of 10.000 Euro, the rate on the transaction date being 3,4 lei/euro and the one on the financial exercise's conclusion N is 3.5 lei/euro. The debt's collection takes place on the 1st of July N+1 on a 3.6 lei/euro rate.

The following operations will be registered:

- the initial recognition of debt:

4111	=	701	34.000 lei

- the exchange rate differences recognition at the end of N exercise:

4111	=	765	1.000 lei

- the debt's deduction and the recognition of the favorable rate difference:

5124	=	%	36.000 lei
		4111	35.000 lei
		765	1.000 lei

2. With the financial exercise's closure, when the debts and duties existing in the balance account are converted to the 31st of December rate, the rate difference being represented by the difference between the *historic rate* and the current exercise rate on the 31st of December. This is treated also as a financial income or financial expense, as it could already be remarked previously.

3. With the financial exercise's closure, when it takes place the compulsory actualization of the foreign currency availabilities to the exchange rate valid for the 31st of December, the rate difference being given by the difference between the rate valid on the patrimony entrance date of the respective currency and the 31st of December rate. This type of difference also generates the registration in the bookkeeping of the society for an income or financial expense.

For example: 'A' society has on its banking account, at the end of N exercise, 1.000 Euro, resulted from the deduction (collection) of a debt on the 2nd of October N on a 3,6 lei/euro rate. On the 31st of December N the valid exchange rate is 3,5 lei/euro.

The bookkeeping for the unfavorable rate difference that appeared is made as follow:

665	=	5124	100 lei

*

* *

A more particular case that cannot be associated to those already mentioned, but which deserves to be cited is the one of foreign currency exchange rate's modification between the date of cashing a forward flow and the delivery date or the one of the effective goods performance, respective of the services.

For instance, in the case of cashing some forward flow before goods' delivery or services performance, the foreign currency exchange rate used for VAT taxing base's calculation at the forward flow's cashing will stay unchanged at the operation's finalization.

VI. IAS 21 incidence – *Foreign exchange rate's variation effects on foreign trade*

On IAS 21 application sphere foreign currency transaction's accountancy is embedded, with the exception of those transactions that are placed in the application area of IAS 39 – *Financial instruments: recognition and evaluation.*

As in Romanian accountancy settlements, IAS 21 presents the manners of initial recognition of external transactions as well those reported on a posterior date.

Thus, according to this standard, a foreign trade operation with goods has on its basis two elements:

- no monetary element represented by transactional goods;
- monetary element represented by debt of duty's deduction.

Accountancy treatment concerning rate differences

A Method: *Foreign exchange rate differences that appear in the monetary elements' deduction moment or in the moment of reporting monetary elements of a society on different courses as compared to those initial registered or as compared to those reported in anterior financial situations should be recognized as incomes or* *expenses in the period when it occur, with the exception of foreign exchange rate differences that should be directly recognized by own assets.*

As it could have been noticed in this paper before, two situations occur:

1. When the transaction's realization and its deduction occur during the same financial exercise, the registration of these elements in accountancy is made by means of two or more operations (see V.1. paragraph, Case A).

2. When the transaction's realization and its deduction occur during different financial exercises, the recognized exchange rate difference in every exercise that intervenes until the deduction moment is generated taking into consideration the exchange rate's modification that took place during each of these exercises (see V.1. paragraph, Case B).

B Method: *Foreign exchange rate differences may result from devaluation or emphasized monetary depreciation, against which no sort of risk cover measures whatsoever may be taken as well as those that affect the duties that cannot be deducted but that appear from the recent acquisition of an asset invoiced in foreign currency. Such rate differences must be included in accountancy value of the respective asset, under the condition that adjusted accountancy value would not cross the minimum between the replacement cost and retrieved amount by asset's selling or use.*

Even though, in a good importation's case, the exchange rate differences are not included in its accountancy value, under the condition that the society is capable of deducting or of covering the foreign currency duty's afferent risks, duty appeared together with the asset acquisition.

When the duty cannot be covered and when no risk cover measures cannot be taken, the exchange rate differences' loses are embedded in the direct costs ascribed to that asset.

For example: 'A' Society imports from Canada on the 1st of June N, an equipment of 100.000 Euro on an exchange rate of 3,4 lei/euro. The exchange rate on the 31^{st} of December N is 3,5 lei/euro. On the 2^{nd} of May N+1, the deduction takes place on an exchange rate of 3,6 lei/euro.

The following operations will be registered:

-the transaction's initial recognition:

2131	=	404	340.000 lei

- the exchange rate differences' recognition at the end of N exercise:

2131	=	404	10.000 lei

- the debt's deduction and the favorable exchange rate difference's recognition:

%	=	5124	360.000 lei
404			350.000 lei
2131			10.000 lei

The application of this accountancy treatment would lead towards the inclusion of exchange rate differences, afferent to immobilities in progress at their value. Thus, unfavorable rate differences may be retrieved during the period of fixed resort, by means of expenses with amortization.

Observations:

a) IAS 29 – *Financial reference in hyperinflation economies,* does not allow this accountancy treatment to be followed in the case with reference to enterprise in a hyperinflation economy currency, meaning in the case when the currency depreciation is not temporary, but it is due to internal inflation process.

b) In Romania, the accountancy treatment presented with *B Method*, is almost never applied, because there exist enough practical means by which the risks of unfavorable exchange rate differences are prevented and counteracted. From this category we mention: covering transactions (hedging), term contracts on monetary market – forward (a foreign currency's purchase future contracts instead of national currency, on current exchange) and duty's anticipatory deduction possibility.

VII. Covering against foreign currency risks' operations' accountancy

Covering against foreign currency risks' operations' accountancy is a recent domain of bookkeeping, its aim being represented by *admitting in achieving of price, exchange rate or interest rate changing,* that intervenes in connection to one or more assets or obligations, that are connected to a market factor and that the firm's administration considered as linked to each other.

A society uses an efficient management when it can appreciate correctly the variant risks to which is exposed and when it can take and apply the most efficient measures in order to diminish those risks.

In this respect, by hedging we can also understand the foreign currency management risks, and the covering risks' operations' accountancy is also called the risk management accountancy.

From an accountant point of view, the risk cover supposes the establishment of one or more risk covering instruments, in such a way that their right value change to compensate totally or partially the right value's changing or the one of the cash flow of a covered element.

In specific literature more examples of covering operation's accountancy may be met, examples settled or used in practice. These have many times different departure points, aspect that lead towards their demarcation in:

- Fair Value Accounting
- Mark-to-Market Accounting
- Deferral Hedge Accounting
- Equity Hedge Accounting

The aspects concerning the accountant hedging against foreign currency risks, that are necessary to be detailed are not simple nor few, but there are going to be the subject of another paper.

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