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Foreign currency transactions: Accounting considerations for banks and microfinance entities in Cambodia.

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Introduction

Cambodia's central bank – the National Bank of Cambodia ("**NBC**") – is the supervisory body for banks and financial institutions (hereafter collectively referred to as "**FSIs**") in Cambodia. The NBC has issued various pieces of regulation which, *inter alia*, contain requirements in relation to:

- The use of a prescribed chart of accounts: This includes two accounts – "foreign-exchange position account" ("**position account**") and "equivalence foreign-exchange position account" ("**equivalence account**") – intended to facilitate the tracking of the scale of an entity's net asset/liability position in foreign currencies and, therefore, its exposure to foreign-exchange risk.

The required financial reporting framework for FSIs is either Cambodian International Financial Reporting Standards ("**CIFRS**") or Cambodian Financial Reporting Standard for Small and Medium-Sized Entities ("**CIFRS for SMEs**"), with those having public accountability being required to apply the former. There are, therefore, two sources of regulation relevant to the accounting for foreign currency transactions and balances relevant to FSIs in Cambodia: that issued by the NBC, and CIFRS/CIFRS for SMEs. This publication explores the use of the position and equivalence accounts, as mandated by the NBC, and the requirements under CIAS 21 (assumes CIFRS reporter), in accounting for transactions and balances denominated in foreign currencies.

1. NBC requirements

1.1. Cross-currency accounting and the position and equivalence accounts

In its second version of the Chart of Accounts Manual, the NBC includes the following two account types:

- Account 29 67 00 equivalence foreign exchange position account – used as a functional currency mirror to the below "position account". Its balance, as at any point in time, representing the functional-currency value of the associated foreign currency's net asset/(liability) holding, at the spot rate, at the reporting date.
- Account 38 60 00 position account foreign exchange – used to record the value of foreign currency (assets)/liabilities – in foreign currency – on an FSI's balance sheet.

Users of the multi-currency accounting systems will require one position account per foreign currency (postings to which will be made in the requisite foreign currencies), and one equivalence account per foreign currency (postings to which will be made in functional currency).

The relevant NBC regulations are namely those of Prakas no. B7-00-50 (February 2000 - "**Prakas**") and the circular on multi-currency accounting following implementation of uniform chart of accounts (February 2005 - "**Circular**").

It is important to note that within the NBC's prescribed chart of accounts it is assumed FSIs' accounting systems have multi-currency capability and, in essence, the base chart of accounts is duplicated for each currency implicated (each subset of currency account codes being referred to as "**ledgers**" below), these accounts being differentiated by the final two digits of the account code as per NBC account code structure convention. The Circular makes it clear that each ledger should net to zero in its own right (in its requisite currency), as should – obviously – the trial balance, in functional currency, as a whole.

An overall foreign-exchange "position" per foreign currency, as the NBC refers to it, is essentially the value of net assets or liabilities held in the foreign currency. The Circular gives examples of how this exchange position is captured, whilst simultaneously maintaining the inherent balance within the individual currency ledgers, when processing cross-currency transactions – that is, when a journal has entries in more than one currency. The Circular, Prakas, and the prescribed chart of accounts explain how the position accounts – being denominated in foreign currencies by design - should be revalued at the spot rate prevailing at each reporting date, with gains/losses being reflected in the profit and loss account. As the functional currency values of the initial postings to the position and equivalence accounts will nearly always be equal (because the position account values will be recorded at the NBC spot rate and, unless the transaction rate differs from this NBC spot rate, so too will the postings to the equivalence accounts), then the revaluing of the position accounts temporarily causes the functional currency values of these two accounts to diverge. These accounts are re-aligned by way of a journal in the functional currency ledger in functional currency, to FX gains/loss, its counter entry being the associated equivalence account. Consequently, as at any reporting date, the functional currency values of the position accounts and the equivalence accounts should net to zero, and have nil impact on equity value.

In the examples and commentary below:
- ***It is assumed that the net asset/liability holdings in foreign currency are purely monetary assets/liabilities***
- ***The currency denomination of the account code being used is shown by the currency symbol in brackets at the end of the account names***

Example 1
Assume Entity XYZ, which has a functional currency of US dollars ($), purchases Euros (€). €10,000 is purchased for $12,000 (€1/$1.2) on 15/01/20X0. Entity XYZ revalues its foreign currency monetary assets/liabilities once per month as part of its month-end routine.

Journal entry required on 15/01/20X0:

Dr bank (€) €10,000
Cr position account (€) €10,000[1]

Dr equivalence account ($) $12,000[2]
Cr Bank ($) $12,000

Example 2
Entity XYZ continues to hold the €10,000 euros until the month end (31/01/20X0). Therefore, they are revalued along with the associated position account. Shortly after month end, €5,000 are sold back into dollars – the entity's functional currency. The revaluation routine was then run at the end of month 02.

1. Month-end revaluation (month 01) - over the remainder of the month, the dollar weakened overall against the Euro, such that the spot rate at the month end values €10,000 at $13,000 (€1/$1.3):

Dr bank (€) $1,000
Cr position account (€) $1,000[3]

Dr equivalence account ($) $1,000[4]
Cr Foreign exchange gain ($) $1,000

This ensures the sum of the position accounts and equivalent accounts, in functional currency, nets to zero at every reporting date.

2. On 14/02/20X0, €5,000 were used to purchase dollars. The spot rate at the point of purchase resulting in $7,250 being received (€1/$1.45):

Dr bank ($) $7,250
Cr equivalence account ($) $7,250

Dr position account (€) €5,000
Cr Bank (€) €5,000

3. Assuming the exchange rate does not then move between the 14th and end of month 02, the revaluation routine will recognise the increase in value during this period on both the €5,000 sold and the €5,000 remaining in the bank:

There will be a residual foreign exchange gain on the euro bank account in respect of the €5,000 sold on the 14th, and an unrealised gain to be recognised for the remaining €5,000 cash at bank balance, each equal to $750. There will be residual debit on the position account in respect of the gain on the sold euros of $750, and the remaining position value will also be revalued upwards (causing a loss) by $750 for the foreign exchange movement on the remaining €5,000 held. There will be a residual credit on the equivalence account of $750 for the €5,000 euros sold, and the remaining equivalence value will also be revalued upwards (causing a gain of $750, in order to match the movement in the position account):

Dr Bank (€) $1,500
Cr position account (€) $1,500

Dr equivalence account ($) $1,500
Cr foreign exchange gain ($) $1,500

1. By increasing the entity's foreign-currency asset value, its position in (and therefore exposure to) euros changes.
2. Booked at the spot rate of the transaction. If the cross-currency transaction rate is different to the spot rate as per the NBC, there will be day 0 FX gain/loss in the discrepancy this creates between the equivalence and position accounts.
3. The position account will reflect the net asset/liability value in the associated foreign currency, so the revaluation of this account will "neutralize" the FX gains/losses on the underlying foreign currency asset/liability position originated through cross-currency transactions until the equivalence accounts are also "revalued".
4. The equivalence accounts are then required to be matched to their respective position accounts' values in functional currency (the divergences are caused by the revaluation of the position accounts, but not the equivalence accounts: due to the former being foreign currency accounts and the latter functional currency accounts) with the change in value taken to foreign exchange gains/losses in the P&L. This being referred to in footnote 3 above as the equivalence accounts being "revalued".

1.2. "Taking up the position" of foreign currency net assets/ equity liabilities recognised through income statement/ equity

Clearly, the transfer of assets/liabilities between foreign currencies and the functional currency (cross-currency transactions – described above) isn't the only way an entity's net asset/liability position in foreign currencies can change: Increases/decreases in foreign currency net assets/liabilities recognised through the income statement/equity within the requisite foreign-currency ledgers also alter the value of, and therefore exposure to, foreign-exchange risk. As the double entries for these are "self-contained" - in that these are not cross-currency transactions - then the "position" of this foreign currency net asset/liability change is not reflected initially on the position and equivalence accounts. In the Circular, the NBC suggests a method of achieving this "uptake of position", illustrated through the example below:

Example 3

During month 02, Entity XYZ recognised a net increase in its euro balance sheet value of €15,000 through the euro income statement account codes. At the month-end the exchange rate was €1/$1.45, and this change in foreign-currency position is captured as follows:

It follows then, that as at the end of month 2, considering the information on Entity XYZ in examples 1 and 2 above, Entity XYZ's net asset holding in euros is €20,000 (the €5,000 held from examples 1 & 2, and the €15,000 generated through the income statement, above); this having a month-end valuation in functional currency of $29,000.

By summing the entries to the position accounts from the three examples above, the closing credit balance, in euros and dollars, is €20,000 and $29,000 respectively.

The credit on the euro position account as at the end of month 02, informs users of a net *asset* holding in euros of €20,000, with a functional-currency value of $29,000.

Summary - Journal entries/balances in foreign currency are shown in foreign currency and functional currency, denoted by currency symbols. It is also assumed that the increase in net assets described in example 3 does not include transactions to the Bank (€) and that there were no other transactions for this company other than those given in the three examples:

Dr P&L (€) €15,000
    Cr position (€) €15,000[5]

Dr equivalence ($) $21,750[6]
    Cr P&L ($) $21,750

Account	Balance as at 1st, month 02, Dr/(Cr)	Transactions in month 02, Dr/(Cr)	Resulting balance prior to revaluation, Dr/(Cr)	Revaluation journals, Dr/(Cr)	"Taking up the position" journals, Dr/(Cr)	Closing balance, month 02, Dr/(Cr)
Bank (€)	€10,000/$13,000	Euros sale: (€5,000)/($7,250)	€5,000/$5,750	€0/$1,500	-	€5,000/$7,250
Position	(€10,000)/($13,000)	Euros sale: €5,000/$7,250	(€5,000)/($5,750)	(€0/$1,500)	(€15,000)/($21,750)	(€20,000)/($29,000)
Equivalence	$13,000	Euros sale: ($7,250)	$5,750	$1,500	$21,750	$29,000
Bank ($)	($12,000)	Euros Sale: $7,250	($4,750)	-	-	(4,750)

5. This being the "taking up of the position" of this foreign currency asset increase recognised through the income statement.
6. Being €15,000*1.45 = $21,750.

2. CIAS 21 and its interaction with the NBC regulations

CIAS 21:20-34 prescribes the appropriate recognition and measurement principles for foreign currency transactions and their resulting balances. In summary, albeit with a number of exceptions, foreign currency transactions are recognised in functional currency using the spot rate on the date of the transaction (CIAS 21:21). Subsequently, non-monetary assets/liabilities are not revalued, but monetary assets and liabilities are revalued at each reporting date using the spot rate prevailing on this date, with the changes in their functional-currency value being recorded in the income statement.

There are no requirements concerning foreign-currency transactions issued by the NBC for which compliance would cause a divergence from the recognition and measurement principles in CIAS 21.

3. Conclusion

There are two sets of regulations governing the accounting for foreign currency transactions by FSIs in the jurisdiction of Cambodia: those issued by the NBC, and those within CIAS 21. Whilst the NBC requirements include the use of position and equivalence accounts as a method of facilitating the monitoring of foreign exchange risk directly from the trial balance, this and the other relevant NBC regulations surrounding foreign currency transactions and balances do not cause divergence from the requirements of CIAS 21.

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