



## **Analysis and Accounting of Hedging of a Net Investment in a Foreign Operation Process in the Concept of Turkish Accounting Standards**

**Veli OZTURK**

Gazi University  
Faculty of Economics and  
Administrative Sciences, Department of  
Health Care Management  
Ankara/TURKEY  
[velioz@gazi.edu.tr](mailto:velioz@gazi.edu.tr)

### **Extensive Summary**

In recent years, in line with developments in the financial markets, financial instruments developed rapidly. As a result of this development, how to classify financial instruments, recognition of these principles has become important. As a result of the every day increase in types of financial instruments, financial risks have emerged. Especially after the end of the Bretton Woods system that based on fixed exchange rates in 1970's, entities faced the financial risk.

IAS 39 gathered financial risks faced by businesses in the financial markets in three groups. These risks are risk arising from financial instruments at fair value and risk arising from cash flows and risk arising from the net investment in a foreign operation. Preventing from the risk arising from the net investment in a foreign operation hedge that composes the subject of this study and also one type of prevention from financial risk, is explained in Turkish Accounting Standards IAS 21 and IAS 39.

At IAS 21, the net investment in a foreign operation, the accounting for investments and foreign exchange differences on disposal of the investment are described. According to the standard, run of the reporting entity's net investment in foreign exchange differences arising on a monetary item that forms part of the reporting entity's separate financial statements and the financial statements of the foreign operation are recognized in profit or loss. In the financial statements consist of Foreign business and the reporting entity (eg consolidated financial statements of the foreign operation is a subsidiary), such exchange differences are recognized initially in a separate component of other comprehensive income, in the position of disposal of the net investment, are recognized as profit or loss.

At IAS 39, the hedging instruments, components and their varieties and how to account for hedging are described. According to the standard, hedges of net investment

in a foreign operation, recognized as part of net investment hedging transactions related to monetary items, including the gain or loss on the hedging instrument determined to be an effective part is recognized in other comprehensive income and gain or loss on the hedging instrument and the ineffective portion is recognized in profit or loss. Related to the effective portion of the hedge and recognized in other comprehensive income and the gain or loss on the hedging instrument, to be sold abroad during or as a reclassification adjustment in the period of disposal by subtracting the gain or loss is reclassified from equity.

The implementation section of this study, one of the varieties of hedging, hedge accounting is an example of a net investment in a foreign operation. In the application example, the business make forward contracts to hedge a net investment in a foreign operation.

At the solution of the implementation part, the provisions of IAS 21 and IAS 39 are taken into consideration. In accordance with the standards, at balance sheet accounts, derivative financial instruments are shown as fixed assets. The fair value of the contract during the contract period at the end of the period to show the valuation differences arising from the valuation of equity are shown in the balance sheet. Net valuation differences raised from the contract, the net investment in a foreign operation disposed of and transferred to the income statement from balance sheet and closed by relating profit or loss raised from disposal.

Example implementation is divided into three sections. In the first part, the increase and decreases at the exchange rates that raised from the position in which the entity made investment does not make forward contracts raised exchange rates are shown. In the second part of our application, the accounting records related to forward contract made for preventing from net investment risk are shown, and how the forward contract prevent the entity from net investment risk is explained. In the final part of the implementation, the disposal of the net investment in a foreign country and it's results are shown.