



IAS 21 The Effects of Changes in Foreign Exchange Rates

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Objective of IAS 21

- The objective of IAS 21 is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency. The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

[Key Definitions 1]

- **Functional currency:**

[Key Definitions 2]

- **Exchange difference:**

[Key Definitions 3]

- **Foreign operation:**

Basic Steps for Translating Foreign Currency Amounts into the Functional Currency 1

- Steps apply to a stand alone entity, an entity with foreign operations (such as a parent with foreign subsidiaries), or a foreign operation (such as a foreign subsidiary or branch).

Basic Steps for Translating Foreign Currency Amounts into the Functional Currency 2

- The reporting entity determines its functional currency
- The entity translates all foreign currency items into its functional currency
- The entity reports the effects of such translation in accordance with [IAS 21. 20-37 and 50]

Foreign Currency Transactions 1

- A foreign currency transaction should be recorded initially at the rate of exchange at the date of the transaction (use of averages is permitted if they are a reasonable approximation of actual). [IAS 21.21-22]

Foreign Currency Transactions 2

- At each subsequent balance sheet date: [IAS 21.23]
- Foreign currency monetary amounts should be reported using the closing rate.
- Non monetary items carried at historical cost should be reported using the exchange rate at the date of the transaction.
- Non monetary items carried at fair value should be reported at the rate that existed when the fair values were determined.

Foreign Currency Transactions 3

- Exchange differences arising when monetary items are settled or when monetary items are translated at rates different from those at which they were translated when initially recognised or in previous financial statements are reported in profit or loss in the period, with one exception. [IAS 21.28]

Foreign Currency Transactions 4

- The exception is that exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognised, in the consolidated financial statements that include the foreign operation, in a separate component of equity; they will be recognised in profit or loss on disposal of the net investment. [IAS 21.32]

Foreign Currency Transactions 5

- If a gain or loss on a non monetary item is recognised directly in equity (for example, a property revaluation under IAS 16), any foreign exchange component of that gain or loss is also recognised directly in equity.
[IAS 21.30]

Foreign Currency Transactions 6

- Prior to the 2003 revision of IAS 21, an exchange loss on foreign currency debt used to finance the acquisition of an asset could be added to the carrying amount of the asset if the loss resulted from a severe devaluation of a currency against which there was no practical means of hedging. That option was eliminated in the 2003 revision.

Foreign Currency Transactions 7

- The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency using the following procedures: [IAS 21.39]

Foreign Currency Transactions 8

- assets and liabilities for each balance sheet presented (including comparatives) are translated at the closing rate at the date of that balance sheet. This would include any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation are treated as part of the assets and liabilities of the foreign operation [IAS 21.47]

Foreign Currency Transactions 9

- income and expenses for each income statement (including comparatives) are translated at exchange rates at the dates of the transactions; and
- all resulting exchange differences are recognised as a separate component of equity.

Foreign Currency Transactions 10

- Special rules apply for translating the results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy into a different presentation currency. [IAS 21.42-43]

[Disposal of a Foreign Operation 1]

- When a foreign operation is disposed of, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that foreign operation shall be recognised in profit or loss when the gain or loss on disposal is recognised. [IAS 21.48]

[Disposal of a Foreign Operation 2]

- Where the foreign entity reports in the currency of a hyperinflationary economy, the financial statements of the foreign entity should be restated as required by IAS 29, Financial Reporting in Hyperinflationary Economies, before translation into the reporting currency. [IAS 21.36]

Disposal of a Foreign Operation 3

- The requirements of IAS 21 regarding transactions and translation of financial statements should be strictly applied in the changeover of the national currencies of participating Member States of the European Union to the Euro monetary assets and liabilities should continue to be translated the closing rate, cumulative exchange differences should remain in equity and exchange differences resulting from the translation of liabilities denominated in participating currencies should not be included in the carrying amount of related assets. **[SIC 7]**

[Disclosure 1]

- The amount of exchange differences recognised in profit or loss (excluding differences arising on financial instruments measured at fair value through profit or loss in accordance with IAS 39). [IAS 21.52]

[Disclosure 2]

- Net exchange differences classified in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
[IAS 21.52]

[Disclosure 3]

- When the presentation currency is different from the functional currency, disclose that fact together with the functional currency and the reason for using a different presentation currency.
[IAS 21.53]

[Disclosure 4]

- A change in the functional currency of either the reporting entity or a significant foreign operation and the reason therefor.
[IAS 21.54]

[Disclosure 5]

- When an entity presents its financial statements in a currency that is different from its functional currency, it may describe those financial statements as complying with IFRS only if they comply with all the requirements of each applicable Standard (including IAS 21) and each applicable Interpretation. [IAS 21.55]

Convenience Translations 1

- Sometimes, an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency simply by translating all amounts at end of period exchange rates. This is sometimes called a convenience translation. A result of making a convenience translation is that the resulting financial information does not comply with all IFRS, particularly IAS 21. In this case, the following disclosures are required: [IAS 21.57]

[Convenience Translations 2]

- Clearly identify the information as supplementary information to distinguish it from the information that complies with IFRS.
- Disclose the currency in which the supplementary information is displayed.
- Disclose the entity's functional currency and the method of translation used to determine the supplementary information.

Discussion on Net Investment in a Foreign Operation: Para 32 1

- The Board discussed whether different accounting treatments should apply to exchange differences on monetary items denominated in different currencies. The Board also discussed whether funding provided to a foreign operation by a group entity that is not the reporting entity may be considered to be part of the reporting entity's net investment in that foreign operation in the context of paragraph 32 of IAS 21.

Discussion on Net Investment in a Foreign Operation: Para 32 2

- The Board agreed that the intention should be to treat third currency denominated monetary items that form a part of the net investment in a foreign operation similar to when the monetary item is denominated in the functional currency of either the reporting entity or the foreign operation.

Discussion on Net Investment in a Foreign Operation: Para 32 3

- The staff proposed to delete paragraph 33 of IAS 21 in order to remove the inconsistency. However the Board indicated a preference to delete only the last two sentences of that paragraph and include additional guidance. The sentences that may be deleted are as follows:

Discussion on Net Investment in a Foreign Operation: Para 32 4

- IAS 21.33 "... However, a monetary item that forms part of the reporting entity's net investment in a foreign operation may be denominated in a currency other than the functional currency of either the reporting entity or the foreign operation. The exchange differences that arise on translating the monetary item into the functional currencies of the reporting entity and the foreign operation are not reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (ie they remain recognised in profit or loss)."

Discussion on Net Investment in a Foreign Operation: Para 32 5

- IAS 21.15 A reporting entity or an entity that is consolidated, proportionately consolidated, or accounted for using the equity method in the reporting entity's consolidated financial statements may have a monetary item that is receivable from or payable to a foreign operation. Such item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the reporting entity's net investment in that foreign operation, and is accounted for in accordance with paragraph 32. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Discussion on Net Investment in a Foreign Operation: Para 32 6

- Some Board members expressed concern whether the above amendment is not sufficiently restrictive to limit its application to a situation where the lender is in a control relationship.

[Reference]

- I recognise the help I received from the materials prepared by Deloitte, Touche, Tohmatsu in preparing this presentation.