IAS 21 THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

FACT SHEET

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This fact sheet is based on existing requirements as at 31 December 2015 and it does not take into account recent standards and interpretations that have been issued but are not yet effective

IMPORTANT NOTE

This fact sheet is based on the requirements of the International Financial Reporting Standards (IFRSs). In some jurisdictions, the IFRSs are adopted in their entirety; in other jurisdictions the individual IFRSs are amended. In some jurisdictions the requirements of a particular IFRS may not have been adopted. Consequently, users of the fact sheet in various jurisdictions should ascertain for themselves the relevance of the fact sheet to their particular jurisdiction. The application date included below is the effective date of the initial version of the standard.

IASB APPLICATION DATE (NON-JURISDICTION SPECIFIC)

IAS 21 was reissued in December 2003 and is applicable for annual reporting periods commencing on or after 1 January 2005.

OBJECTIVE

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.

SCOPE

IAS 21 applies in:

- accounting for transactions and balances in foreign currencies except for derivative transactions and balances that are within the scope of IAS 39 *Financial instruments: recognition and measurement;*
- translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation or the equity method; and
- translating entity's results and financial position into a presentation currency.

RECOGNITION

Functional currency

All transactions are recognised in the functional currency of the entity. All currencies other than the functional currency are foreign currencies. A legal or economic entity may have more than one functional currency if it has a foreign operation (subsidiary, associate, joint venture or branch with activities based or conducted in a different country or currency). The basis for determining each entity's functional currency is discussed below.

The functional currency of an entity depends on the primary economic environment, which is normally the environment in which the entity primarily generates and expends cash. Primary factors considered in identifying the functional currency are:

a. the currency:
   - that mainly influences sales prices for goods and services; and
   - of the country whose competitive forces and regulations determine the sales price of its goods and services;

b. the currency that mainly influences labour, material and other costs of providing goods or services.

The following may also provide evidence of the functional currency; however the results of these tests do not over-ride the results of the primary factors test:

- the currency in which funds are generated from debt and equity instruments; and
- the currency in which receipts from operating activities are usually retained.

In determining the functional currency of a foreign operation and whether its functional currency is the same as the reporting entity (the reporting entity in this context being the entity that has the foreign operation as its subsidiary, branch, associate or joint venture):

a. whether its activities are an extension of the reporting entity's activities rather than involving significant degree of autonomy;
b. the proportion of its transactions that are with the reporting entity;
c. whether its cash flows directly affect those of the reporting entity and are readily distributable to it; and
d. whether its cash flows are sufficient to service its existing and normally expected debt obligations without funding assistance from the reporting entity.

Initial recognition

A foreign currency transaction is recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

Subsequent reporting periods

At the end of each subsequent reporting periods:

- any foreign currency monetary items are translated using the closing rate;
- non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of transaction; and
- non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Exchange differences

Any exchange difference arising on the settlement of a monetary item or on translating monetary items at rates different from those in which they were translated on initial recognition during the period or in previous financial statements, are included in profit or loss in the period in which they arise unless it relates to exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation. These exchange differences are recognised in the profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation as appropriate. In the financial statements that includes the foreign operation and the reporting entity (e.g. the consolidated financial statements when the foreign operation is a subsidiary), such exchange differences are recognised initially in other comprehensive income and reclassified from equity to profit or loss on disposal of the net investment.

When a gain or loss on a non-monetary item is recognised in other comprehensive income, any exchange component of that gain or loss is recognised in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.

Translation into presentation currency

An entity may elect to present its financial report in any currency (referred to as the presentation currency). For operations where the functional currency is not the presentation currency:

- assets and liabilities for each statement of financial position presented (including comparatives) are translated to the presentation currency using the closing rate at the date of that statement of financial position;
- income and expenses for each statement presenting profit or loss and other comprehensive income (including comparatives) are translated using the exchange rate at the transaction dates; and
- any resulting exchange difference are recognised in other comprehensive income.

For groups, translation of each entity within the group to the group's presentation currency is performed before preparing the consolidated financial report. A similar process is also adopted in an individual entity's financial statements where, for example, there is a branch operation with a different functional currency.

DISCLOSURES

Refer to Appendix 1 for a checklist to assist with IAS 21 disclosure requirements.

DEFINITIONS

Closing rate	Spot exchange rate at the end of the reporting period.
Exchange differences	The difference resulting from translating a given number of units of one currency into another currency at different exchange rates.
Exchange rate	The ratio of exchange for two currencies.
Foreign currency	A currency other than the functional currency of the entity.
Foreign operation	An entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.
Functional currency	The currency of the primary economic environment in which the entity operates.
Net investment in a foreign operation	The amount of the reporting entity's interest in the net assets of that operation.
Presentation currency	The currency in which the financial statements are presented.
Spot exchange rate	The exchange rate for immediate delivery.

RELATED INTERPRETATIONS

- IFRIC 16 *Hedges of a Net Investment in a Foreign Operation*
- SIC 7 *Introduction of the Euro*

AUSTRALIAN SPECIFIC REQUIREMENTS

The Australian equivalent standard is AASB 121 *The Effects of Changes in Foreign Exchange Rates*. The equivalent Australian interpretations are:

- Interpretation 16 *Hedges of a Net Investment in a Foreign Operation*
- Interpretation 107 *Introduction of the Euro*.

REDUCED DISCLOSURE REQUIREMENTS (RDR)

On 30 June 2010, the Australian Accounting Standards Board published AASB 1053 *Application of Tiers of Australian Accounting Standards* (and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements*) which established a differential reporting framework, consisting of two Tiers of reporting requirements for preparing general purpose financial statements:

a. Tier 1: Australian Accounting Standards; and

b. Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

A Tier 2 entity is a ‘reporting entity’ as defined in SAC 1 *Definition of the Reporting Entity* that does not have ‘public accountability’ as defined in AASB 1053 and is not otherwise deemed to be a Tier 1 entity by AASB 1053.

RDR is applicable to annual periods beginning on or after 1 July 2013.

When developing AASB 1053, the AASB concluded that the Australian Government and State, Territory and Local Governments should be subject to Tier 1 requirements. The AASB also decided that General Government Sectors of the Australian Government and State and Territory Governments should continue to apply AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, without the reduction in disclosures provided by Tier 2. Other public sector entities are able to apply Tier 2 reporting requirements.

The requirements that do not apply to RDR entities are identified in Appendix 1 by shading of the relevant text.

APPENDIX 1 – DISCLOSURE CHECKLIST

This checklist can be used to review your financial statements. You should complete the “Yes / No / N/A” column about whether the requirement is included. To ensure the completeness of disclosures, provide an explanation for “No” answers.

CODE		YES / NO / N/A	EXPLANATION (*If required*)
IAS 21.52	Has the entity disclosed: a. the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with IAS 39; and b. net exchange differences recognised in other comprehensive income and accumulated 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 21.53	If the presentation currency is different from the functional currency, has the entity disclosed this fact, together with the disclosure of the functional currency and the reason for using a different presentation currency?		
IAS 21.54	Have there been changes in the functional currency of either the reporting entity or a significant foreign operation? If yes, has that fact and the reason for the change in functional currency been disclosed?		
IAS 21.55	Does the entity present its financial statements in a currency that is different from its functional currency? If yes, has the entity described the financial statements as complying with IFRSs only if they comply with all the requirements of IFRSs including the translation method set out in paragraphs 39 and 42?		
IAS 21.57	Does the entity display its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and it does not meet the above requirements at IAS 21.55 has the entity: a. clearly identified the information as supplementary information to distinguish it from the information that complies with IFRSs; b. disclosed the currency in which the supplementary information is displayed; and c. disclosed the entity’s functional currency and the method of translation used to determine the supplementary information?		

OTHER MATTERS

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