

Classification of a Foreign Exchange Difference from an Intragroup Monetary Liability (or Asset) (IFRS 18 *Presentation and Disclosure in Financial Statements*)

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The Committee received a request about the classification of a foreign exchange difference from an intragroup monetary liability (or asset). Paragraph B65 of IFRS 18 requires an entity to ‘classify foreign exchange differences included in the statement of profit or loss applying IAS 21 [*The Effects of Changes in Foreign Exchange Rates*] in the same category as the income and expenses from the items that gave rise to the foreign exchange differences, unless doing so would involve undue cost or effort (see paragraph B68)’.

The request asked how an entity applying paragraph B65 of IFRS 18 classifies a foreign exchange difference if the income and expenses from the intragroup monetary liability (or asset) that gave rise to the foreign exchange difference have been eliminated on consolidation.

Fact pattern

In the fact pattern described in the request, an entity enters into a loan with its subsidiary (intragroup loan). The entity and its subsidiary have different functional currencies. This intragroup loan:

- a. is denominated in the functional currency of either the entity or its subsidiary; and
- b. is not part of the entity’s net investment in the subsidiary.

The entity or the subsidiary for which the intragroup loan is a foreign currency monetary item applies IAS 21 to translate the loan to its functional currency and recognises any resulting exchange difference in profit or loss (the exchange difference). In preparing its consolidated financial statements in accordance with IFRS 10 *Consolidated Financial Statements*, the entity eliminates in full the intragroup assets, liabilities, income, expenses and cash flows relating to the loan. However, in accordance with paragraph 45 of IAS 21, the entity does not eliminate the exchange difference and recognises that exchange difference in its consolidated statement of profit or loss.

Applying the requirements in IFRS Accounting Standards

To determine how an entity classifies the exchange difference in accordance with paragraph B65 of IFRS 18, the Committee considered what ‘the items that gave rise to the foreign exchange differences’ are.

Paragraph 45 of IAS 21 states ‘[t]he incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see IFRS 10 *Consolidated Financial Statements*). However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations...’.

The Committee observed that—according to paragraph 45 of IAS 21—it is the intragroup monetary liability (or asset) that gives rise to the exchange difference. The monetary item represents a commitment to convert one currency into another currency.

Consequently, the Committee concluded that a reasonable reading of paragraph B65 of IFRS 18 applied to the fact pattern described in the request results in two possible ways (described as View 1 and View 2 in this agenda decision) to classify the exchange difference.

View 1—Classify the exchange difference in the operating category as the default category

The income and expenses from the item that gave rise to the exchange difference are not included in the consolidated statement of profit or loss. Consequently, the entity could reasonably conclude it cannot apply paragraph B65 of IFRS 18 to this exchange difference because there is no ‘same’ category within which the entity can classify the exchange difference. The entity therefore, by default, classifies the exchange difference in the operating category in accordance with paragraph 52 of IFRS 18.

View 2—Classify the exchange difference in the same category in which the income and expenses from the intragroup loan would have been classified before their elimination on consolidation, or, if doing so would involve undue cost or effort, in the operating category

The entity might consider that the exchange difference arose from the intragroup loan before the elimination of that loan—and of any income and expenses (other than the exchange difference) arising from that loan—on consolidation.

The Committee observed that while paragraph B65 of IFRS 18 requires the exchange difference to be classified in the ‘same’ category as the income and expenses from the item that gave rise to the exchange difference, it does not require those income and expenses to be included in the consolidated statement of profit or loss.

Therefore, applying paragraph B65 of IFRS 18, the entity could reasonably conclude it can classify the exchange difference in the category in which the income and expenses from the intragroup loan would have been classified before the elimination of those income and expenses.

The Committee observed that applying View 2:

- a. if the entity determines—in accordance with paragraph B68 of IFRS 18—that classifying the exchange difference in the same category in which the income and expenses would have been classified before their elimination involves undue cost or effort, the entity instead classifies the exchange difference in the operating category. In accordance with paragraph B68 of IFRS 18, an entity assesses whether classifying foreign exchange differences involves undue cost or effort ‘for each item that gives rise to foreign exchange differences.’
- b. the entity classifies the exchange difference from its perspective (as a consolidated group). This means, for example, that the category in which the entity classifies the exchange difference might differ from the category in which the subsidiary classified the exchange difference in its statement of profit or loss (if applicable to the subsidiary). A reason those categories might differ is if the entity’s assessment of its specified main business activities—

as a consolidated group—differs from the subsidiary’s assessment of its specified main business activities.

Other views

The Committee concluded that the other views described in the request would not be reasonable readings of the requirements. Those views were that:

- a. the transaction in the fact pattern involves only the raising of finance and, consequently, the entity classifies the exchange difference in the financing category. The Committee concluded that this view is not a reasonable reading of the requirements because the exchange difference does not always arise from a transaction that involves only the raising of (intragroup) finance.
- b. the exchange difference arose from the transfer of cash from one currency into another for a period of time and, consequently, the entity classifies the exchange difference in the investing category. The Committee concluded that this view is not a reasonable reading of the requirements because it is not cash (or currency) that gave rise to the exchange difference.

Other observations

The Committee observed that an entity develops and applies an accounting policy—that is, View 1 or View 2 as described in this agenda decision—in accordance with IAS 8 *Basis of Preparation of Financial Statements*.

Conclusion

In the light of its analysis, the Committee considered whether to add a standard-setting project to the work plan. The Committee concluded that the expected benefits of a standard-setting project to further clarify the classification of the exchange difference in the fact pattern described in the request would not outweigh the costs. Consequently, the Committee decided not to add a standard-setting project to the work plan.

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