

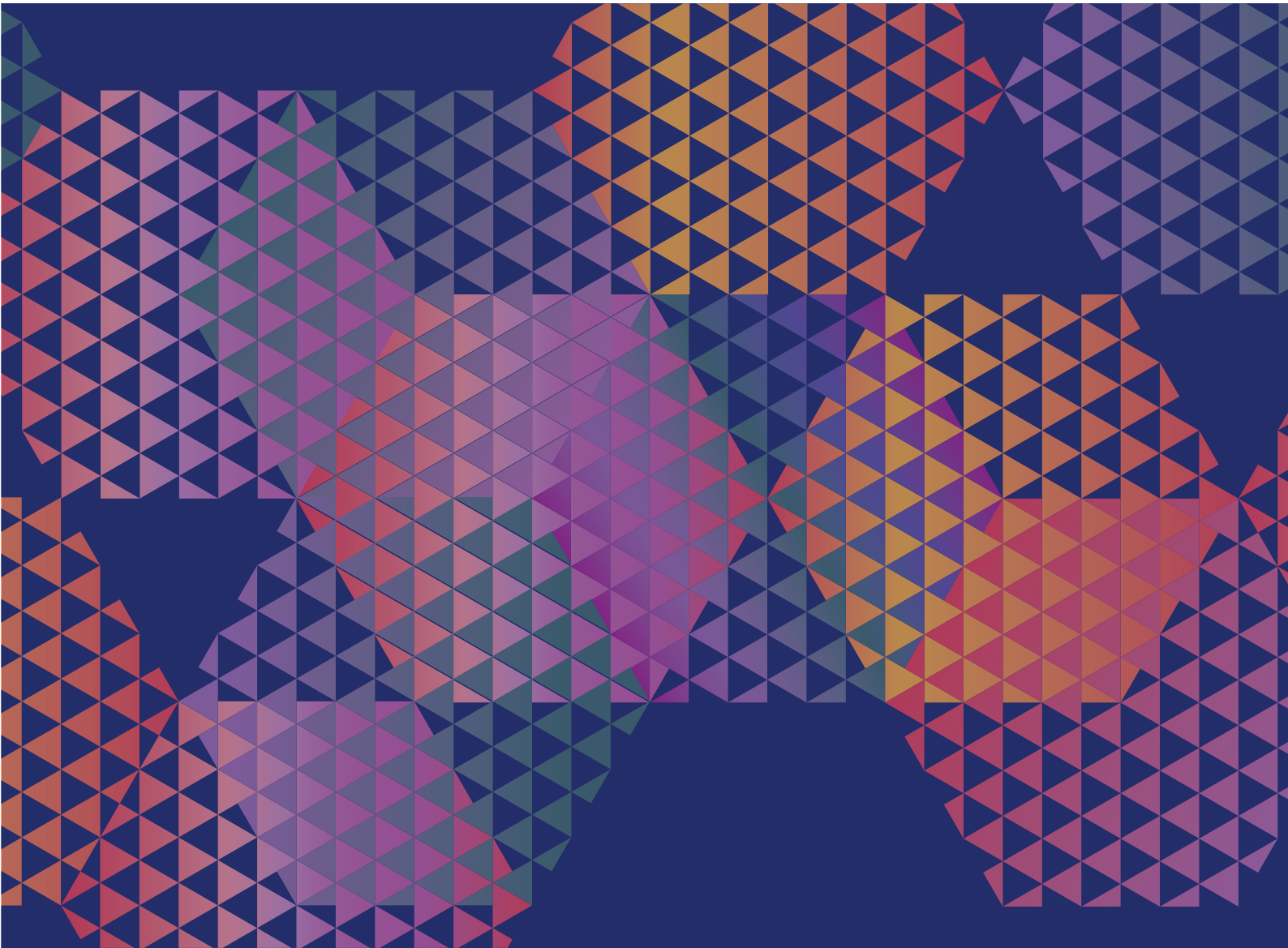


IFRS[®]
Accounting

Educational Module 30
Foreign Currency Translation

IFRS for SMEs[®]

Accounting Standard
Third Edition



International Accounting Standards Board

IFRS[®] Foundation
Supporting Material for the
IFRS for SMEs[®] Accounting Standard

including the full text of
Section 30 *Foreign Currency Translation* of the
IFRS for SMEs Accounting Standard issued by
the International Accounting Standards Board in February 2025

with extensive explanations, self-assessment questions and case studies

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The requirements of Section 30 *Foreign Currency Translation* of the *IFRS for SMEs Accounting Standard* are set out in this module and shown with grey shading. Appendix B of the *IFRS for SMEs Accounting Standard* (Glossary) is also part of the requirements. Terms defined in the Glossary are reproduced in **bold type** the first time they appear in the text of Section 30.

This module has been prepared by International Accounting Standards Board (IASB) technical staff. The educational notes and examples inserted by the staff are not shaded. These educational notes and examples do not form part of the *IFRS for SMEs Accounting Standard* and have not been approved by the IASB.

INTRODUCTION

What is the *IFRS for SMEs*® Accounting Standard?

The *IFRS for SMEs Accounting Standard* (Standard) is intended for use by entities that publish financial statements and that do not have public accountability (referred to as small and medium-sized—see Section 1 *Small and Medium-sized entities* of the Standard).

The objective of financial statements is to provide information about a reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity.

More information about the Standard and its supporting materials is available on the IFRS Foundation website: www.ifrs.org.

What does this module cover?

This educational module focuses on the general requirements on 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 that is different from the functional currency applying Section 30 *Foreign Currency Translation* of the *IFRS for SMEs Accounting Standard*. This module:

- provides explanatory notes and examples designed to improve understanding of the requirements;
- identifies the significant judgements required in applying Section 30;
- includes questions designed to test your understanding of the requirements; and
- provides case studies that provide a practical opportunity to apply the requirements to account for foreign currency transactions and to perform foreign currency translations applying the *IFRS for SMEs Accounting Standard*.

After completing this module, you should, within the context of the *IFRS for SMEs Accounting Standard*, be able to:

- identify the functional currency of a stand-alone entity;
- identify the functional currency of a foreign operation of another entity;
- demonstrate an understanding of the significant judgements required in identifying an entity's functional currency;
- record foreign currency transactions on initial recognition;
- account for foreign currency monetary items subsequent to initial recognition;
- account for non-monetary items measured in a foreign currency subsequent to initial recognition;
- identify and account for monetary items that form part of the entity's net investment in a foreign operation;
- translate financial statements from an entity's functional currency to a different presentation currency;
- incorporate foreign operations in the financial statements of an entity; and
- prepare disclosures in accordance with Section 30.

Which version of the Standard does the module refer to?

Any reference in this module to 'the *IFRS for SMEs Accounting Standard*' is to the third edition of the Standard, issued February 2025.

What is in the requirements?

The objective of an entity's financial statements is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors when making decisions related to providing resources to the entity.

Section 30 prescribes 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 Section requires each entity to identify its functional currency. An entity's functional currency is 'the currency of the primary economic environment in which the entity operates' (see paragraph 30.2). An entity is required to record all its foreign currency transactions on initial recognition in its functional currency.

Section 30 also contains requirements on subsequent measurement for foreign currency monetary items and non-monetary items measured in a foreign currency, and presentation of any exchange differences that arise on remeasurement.

An entity may present its financial statements in any currency (known as the presentation currency). If the presentation currency differs from the entity's functional currency, the entity is required to follow the procedure set out in Section 30 to translate its items of income and expense and financial position into the presentation currency. If a group contains individual entities with different functional currencies, 'the items of income and expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented' (see paragraph 30.17).

What has changed in the third edition of the Standard?

Section 30 of the *IFRS for SMEs Accounting Standard* now includes requirements relating to lack of exchangeability and advance consideration. The Standard:

- (a) describes how an SME identifies whether a currency is exchangeable and prescribes the exchange rate to be used in this situation (see paragraph 30.5A and the Appendix to Section 30); and
- (b) includes a requirement for determining the exchange rate to use in transactions that involve advance consideration paid or received in a foreign currency (see paragraph 30.8A).

Transition requirements are explained on page 76 of this educational module.

REQUIREMENTS AND EXAMPLES

Scope of this section

- 30.1 An entity can conduct foreign activities in two ways. It may have transactions in foreign currencies or it may have **foreign operations**. In addition, an entity may present its **financial statements** in a foreign currency. This section prescribes 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**. Accounting for **financial instruments** that derive their value from the change in a specified foreign exchange rate (for example, foreign currency forward exchange contracts) and hedge accounting of foreign currency items are dealt with in Part II of Section 11 *Financial Instruments*.

Educational notes

Foreign activities

An entity is required to determine its functional currency in accordance with paragraphs 30.2–30.5, and transactions in currencies that are not the entity’s functional currency are therefore in a foreign currency.

An entity conducts foreign activities if it has either transactions denominated in a currency other than the functional currency, or if it has foreign operations.

A foreign operation is defined in the Glossary as ‘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.’

Other parts of Section 30 specify accounting requirements when an entity conducts foreign activities or chooses to present its financial statements in a currency other than its functional currency (for example, in a foreign currency).

Relationship between Section 30 and other sections

The recognition and measurement requirements in financial statements are governed by relevant sections of the Standard. For example, property, plant and equipment purchased in a foreign currency is recognised and measured in accordance with Section 17 *Property, Plant and Equipment*. Section 17 applies when an entity decides when to recognise an item of property, plant and equipment and decides which accounting policy to apply (either the cost model or the revaluation model). Section 30 sets out requirements translating the relevant amounts into an entity’s functional currency or its presentation currency.

Financial instruments denominated in a foreign currency are recognised and measured in accordance with Section 11 *Financial Instruments*. However, in most cases, Section 30 will still apply in translating the amount determined in accordance with Section 11 into an entity's functional currency. For example, a foreign currency denominated loan payable that meets the requirements to be measured at amortised cost in Section 11 is first measured at amortised cost in the currency in which the loan is denominated before translating that amount into the functional currency, using the exchange rate at the reporting date (the closing rate) (see the treatment of monetary items in paragraph 30.9(a)).

Foreign currency derivatives (such as foreign currency forward exchange contracts, foreign currency futures and foreign currency options) are also accounted for in accordance with Section 11. Section 30 does not apply to these derivatives. It also does not apply when measuring foreign currency items subject to hedge accounting—see Section 11. However, Section 30 does apply to all financial instruments and financial instrument transactions if an entity chooses to translate its financial statements from its functional currency to a different presentation currency (see paragraphs 30.17–30.21).

Section 7 *Statement of Cash Flows* specifies requirements in relation to cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (see paragraphs 7.11–7.13).

Translation to presentation currency

An entity accounts for foreign currency transactions in its functional currency. However, in accordance with paragraph 30.17, an entity can choose to present its financial statements in any currency. If the presentation currency differs from the entity's functional currency, the entity is required to translate its items of income and expense and financial position into the presentation currency (see paragraphs 30.17–30.21). For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented (see paragraphs 30.22–30.23).

Functional currency

30.2 Each entity shall identify its **functional currency**. An entity's functional currency is the currency of the primary economic environment in which the entity operates.

Educational notes

An entity is required to measure its results and financial position in its functional currency. For most entities, the functional currency is the currency of the country in which the entity is located (the local currency). However, it cannot be assumed that the local currency will in all cases be the functional currency. For example, if the entity has significant transactions priced mostly according to the economic forces of another country that has a different currency, then its functional currency might be that other currency.

An entity's functional currency is determined in accordance with the guidance provided in paragraphs 30.3–30.5. In many cases, the indicators will clearly identify a particular currency as the functional currency. In other cases they will not. When the factors provide a mixed result and the functional currency is not obvious, management must use its judgement to determine the functional currency.

- 30.3 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. Consequently, the following are the most important factors an entity considers in determining its functional currency:
- (a) the currency:
 - (i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and
 - (ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
 - (b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

Educational notes

The factors in paragraph 30.3 are the primary indicators of an entity's functional currency because they are closely linked to the primary economic environment in which the entity operates. Consequently, the factors in paragraph 30.3 are given more weight than other factors when identifying the functional currency of an entity. The secondary indicators listed in paragraphs 30.4–30.5 provide supporting evidence of an entity's functional currency.

If all the factors in paragraph 30.3 clearly point to the same currency, that currency is the functional currency of the entity. Otherwise, supporting factors in paragraphs 30.4–30.5 should additionally be considered when determining the functional currency.

Paragraph 30.3(a)(i)

In determining an entity's functional currency, Section 30 gives greater emphasis to the currency that most strongly influences the pricing of the entity's sale transactions than to the currency in which those transactions are denominated. However, the currency will often be the same in both cases.

Where an entity mainly sells its products locally, sale prices are usually determined in the local currency and revenue is usually collected primarily in that local currency, so paragraph 30.3(a)(i) would indicate that the local currency is the functional currency.

Paragraph 30.3(a)(ii)

Where the sales prices of an entity's products are most strongly influenced by competition with other entities in the same country and by regulation and law in the entity's own country rather than by international competition and regulation, paragraph 30.3(a)(ii) would indicate that the local currency is the functional currency.

Paragraph 30.3(b)

Section 30 gives greater emphasis to the currency that most strongly influences the entity's expenditure, rather than focusing on the currency in which those expense transactions are denominated. However, often the currency will be the same in both cases.

Considering paragraphs 30.3–30.5, management should prioritise the indicators in paragraph 30.3 before considering the indicators in paragraphs 30.4–30.5. However, the relative importance of the indicators will vary from entity to entity. In assessing each indicator's relative importance, management should consider the significance of that indicator to the entity's operations. For example, the primary and secondary indicators in paragraphs 30.3–30.4 apply to the majority of entities that provide goods and services; but some of these indicators may not be directly relevant to some other types of entities, such as some special-purpose entities and holding entities.

Management should also consider how clearly each indicator identifies a currency as the functional currency. An indicator that is clear—one that identifies only one currency—would carry more weight than an indicator that identifies several currencies, but that may provide slightly more support for one of them. For example, if costs of providing goods are incurred in both the local currency and a foreign currency, but with slightly more costs incurred in the local currency, paragraph 30.3(b) would indicate a slight preference for the local currency. However, if the costs of providing goods were incurred only in the local currency, the indicator under paragraph 30.3(b) would provide stronger support for the local currency as being the functional currency (the indicator would carry more weight when assessed with indicators providing weaker support for certain currencies).

Example—Functional currency is the local currency

Ex 1 A stand-alone SME—one that is not a foreign operation of another entity—manufactures a product for the domestic market in Country A. Its sales are denominated in the local currency of Country A (LCA). The price of its product in Country A is affected mainly by local supply and demand and regulations.

The SME's inputs are sourced in Country A and the prices of the inputs are denominated in LCA and are mainly influenced by economic forces and regulations in Country A.

In the absence of evidence to the contrary, the SME's functional currency is the LCA—market forces and regulations in Country A's economy largely determine:

- the selling price of the SME's output—the price of its product in Country A is affected mainly by supply and demand in Country A and sales are denominated and settled in LCA; and
- the costs of the SME's inputs—the SME's inputs are sourced locally and prices are denominated in LCA.

Example—Functional currency is not the local currency

Ex 2 A stand-alone SME mines a commodity in Country A. The currency of Country A is the LCA. Sales of the commodity are denominated in the local currency of Country Z (LCZ). The LCZ sales price of the commodity is affected by global supply and demand. Country Z accounts for about 50% of global demand for the commodity.

About 90% of the SME's costs are for expatriate staff salaries and for chemicals and specialised machinery imported from Country Z. These costs are denominated and settled in LCZ. The SME's other costs are incurred and settled in LCA.

In the absence of evidence to the contrary, the SME's functional currency is the LCZ. Market forces in Country Z's economy largely determine:

- the selling price of the SME's output—Country Z is a major contributor to the global market demand for the commodity and the SME's sales are denominated in and settled in LCZ; and
- the costs of the SME's inputs—competitive forces and regulations in Country Z mainly determine the cost price of the SME's inputs (about 90% of its costs are sourced from Country Z and denominated and settled in LCZ).

- 30.4 The following factors may also provide evidence of an entity's functional currency:
- (a) the currency in which funds from financing activities (issuing debt and **equity** instruments) are generated; and
 - (b) the currency in which receipts from operating activities are usually retained.

Educational notes

The indicators in paragraph 30.4 provide supporting evidence of an entity's functional currency. They are given less priority than the factors in paragraph 30.3.

When an entity raises finance, for example, by issuing debt and equity instruments, the currency in which it does so corroborates other evidence that a currency is the entity's functional currency. The currency in which the entity raises finance is less significant if the entity is financing itself primarily through retained earnings.

Where operating activities are the principal revenue-producing activities of the entity, the currency in which receipts from such activities are usually retained (the currency in which the entity maintains its excess working-capital balance) corroborates other evidence that the entity's functional currency is that in which the receipts from revenue-producing activities are usually denominated.

Example—Primary indicators are mixed

Ex 3 A stand-alone SME based in Country A manufactures a product in Country A for export to Country B. Labour and raw materials are relatively inexpensive in Country A.

The SME's sales prices are nearly always denominated in LCB (the local currency of Country B) and are mostly based on prices set by competitive forces in Country B and by Country B's regulations. Customers settle in LCB and the SME holds its excess cash in LCB, only converting sufficient LCB into LCA (the local currency of Country A) to settle its operating costs as they fall due.

Most of the SME's borrowings are in LCB. However, most costs are paid in LCA. Specialised machinery is purchased from suppliers in Country C. Those purchases are denominated in LCC (the local currency of Country C). Such costs are not significant when compared with the LCA-denominated operating costs.

Competitive forces and regulations in Country B are the predominant influences on the sales prices of the SME's products, which indicates that LCB is the SME's functional currency. However, LCA is also indicated as possibly being the SME's functional currency because most of its costs for raw materials and labour are mainly influenced by competitive forces in Country A.

Economic forces in Country C are not considered in the assessment of the functional currency because the cost of the machinery imported from Country C is insignificant.

Because the factors in paragraph 30.3 are mixed, management should consider the factors in paragraph 30.4. Those factors corroborate LCB as being the SME's functional currency because the SME generates funds from financing activities in LCB and holds most of its cash reserves in LCB.

Without evidence to the contrary, the factors in paragraphs 30.3–30.4 support LCB as the SME's functional currency. Management would apply judgement and consider all relevant information before concluding that LCB is the functional currency.

30.5 The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its **subsidiary**, branch, **associate** or **joint arrangement**):

- (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, instead of being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other **monetary items**, incurs **expenses**, generates **income** and arranges borrowings, all substantially in its local currency.
- (b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.
- (c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
- (d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

Educational notes

The Glossary defines a foreign operation as 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.'

The factors in paragraph 30.5, which provide supporting evidence of an entity's functional currency, should only be taken into consideration in addition to those in paragraph 30.4 when the entity is a foreign operation of another entity. Priority is given to the primary indicators in paragraph 30.3.

Because associates and joint arrangements are more likely to be operating independently of the investor or party to the joint arrangement (because they are not controlled by the investor or party to the joint arrangement), the indicators in paragraph 30.5 are more likely to be positive for subsidiaries and branches than for associates and joint arrangements.

Paragraph 30.5(a)

Activities of the foreign operation carried out as an extension of the reporting entity provide supporting evidence that the functional currency of the foreign operation is the same as that of the reporting entity.

Where a foreign operation is set up as a special-purpose entity whose activities are clearly being conducted on behalf of the parent entity—perhaps as a tax-efficient way to effect a lease or to undertake research and development—it would usually be expected to have the same functional currency as that of the reporting entity.

Paragraph 30.5(b)

A foreign operation that transacts most of its activities with the reporting entity provides supporting evidence that the functional currency of the foreign operation is the same as that of the reporting entity.

Paragraph 30.5(c)

Cash flows from the activities of the foreign operation that directly affect the cash flows of the reporting entity and are readily available for remittance to the reporting entity would provide supporting evidence that the functional currency of the foreign operation is the same as that of the reporting entity.

Paragraph 30.5(d)

Cash flows from the activities of the foreign operation are insufficient to service existing and normally expected debt obligations without funds made available by the reporting entity (the entity has significant financial support from the reporting entity to enable it to service its debt obligations), provide supporting evidence that the functional currency is the same as that of the reporting entity.

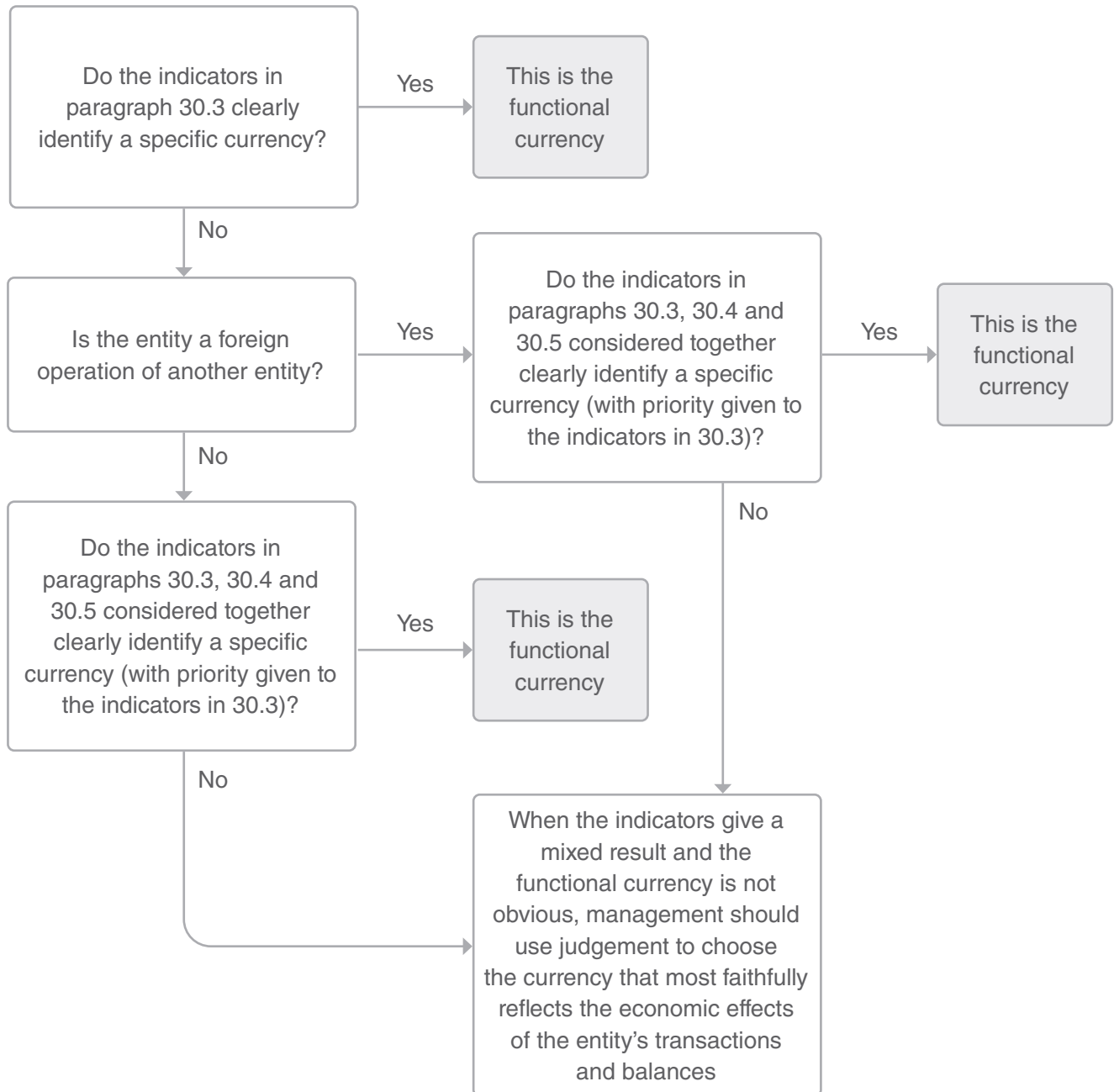
Branches

A foreign operation may be a branch of a reporting entity. Although a branch is legally part of the reporting entity, it may in substance be operating as a separate foreign operation. If a single entity has two or more distinct divisions operating in different economic environments, it may be appropriate for each division to have its own functional currency. For example, it may be appropriate to determine the functional currency of each division separately if each division of the entity is in a different country, each division sells its own products to customers in its own country and each division is managed separately, including maintaining separate accounting records.

Once the entity's functional currency has been determined, the results and financial position of the entity's branches that have a different functional currency would be included in the accounts of the reporting entity, using the translation method in paragraph 30.22.

The following flow chart illustrates the approach in determining the functional currency of an entity based on paragraphs 30.3–30.5.

Figure 1—Approach to determining the functional currency of an entity



Example—Foreign subsidiary operates with little interference from the parent

Ex 4 A parent company whose functional currency is the LCA (the local currency of Country A) manufactures influenza remedies in Country A. It has a subsidiary that is an SME in Country Z. The subsidiary is predominantly financed by a loan denominated in LCZ (the local currency of Country Z).

The SME operates with significant autonomy from the parent. Management of the SME determines, without interference from the parent entity, the prices of its products, which are influenced mainly by local competition and regulations. The SME uses some of the parent's formulas under licence. It also develops and produces some of its own formulas to meet local preferences and local health and safety regulations. It manufactures its own products in Country Z with locally sourced raw materials and local labour. It sells its products to customers in Country Z. Some specialised machinery is purchased from abroad but the cost of such equipment is insignificant in relation to other operating costs.

The factors in paragraph 30.3(a) indicate that LCZ is the functional currency of the SME. LCZ is the currency in which the sales prices are denominated and settled. In addition, the SME's sales prices are determined by competition and regulation in Country Z. Prices are not significantly affected by international competition or by regulations and changes in exchange rates between LCZ and other currencies.

Paragraph 30.3(b) also indicates LCZ as the SME's functional currency because the most significant costs are denominated and settled in LCZ.

All of the factors in paragraph 30.3 indicate LCZ. Consequently, without evidence to the contrary, LCZ is the functional currency of the SME. The SME does not need to consider the factors in paragraphs 30.4–30.5.

Example—Foreign special purpose entity

Ex 5 A parent entity whose functional currency is the LCA (the local currency of Country A) manufactures influenza remedies in Country A.

The parent forms an SME subsidiary in Country B for the sole purpose of undertaking research and development activities for the parent. Other than paying its suppliers and employees for raw materials and labour in LCB (the local currency of Country B), its only transactions are with the parent.

The SME is financed mainly by the parent through an LCA-denominated loan. The parent pays the SME an LCA-denominated fee for its research and development services, and the parent provides its subsidiary with any necessary equipment for the research and development. That fee is sufficient to settle local expenses.

The SME's only operations are performing research and development activities for the parent entity. The SME's only income is an amount from the parent sufficient to pay local fees. Consequently, the factors in paragraph 30.3(a) are not directly relevant. Paragraph 30.3(b) is relevant but on its own it would not be sufficient to conclude that LCB is the functional currency of the SME.

The factors in paragraph 30.4–30.5 should also be considered. Paragraph 30.4(a) indicates LCA as the functional currency because the entity is financed by an LCA-denominated loan from the parent. Paragraph 30.4(b) is less relevant because the parent provides the entity with a fee to pay its expenses and there are no amounts retained.

Paragraph 30.5 supports LCA being the functional currency:

- the activities of the SME are carried out as an extension of the parent, without significant autonomy because the subsidiary is performing research and development activities for the parent based on the parent's instructions;
- transactions with the parent are a high proportion of the SME's activities because the parent pays all the SME's costs; and
- cash flows from the activities of the SME are insufficient to service the loan from the parent without the fee from the parent.

Paragraph 30.5(c) is not directly relevant because there are no cash flows from the activities of the SME other than from the parent to settle the SME's local costs.

Paragraphs 30.3, 30.4 and 30.5 considered together support LCA as the functional currency. Without evidence to the contrary, it is expected that LCA is the functional currency. Management should apply judgement and consider all relevant information before concluding that LCA is the functional currency.

Estimating the spot exchange rate when a currency is not exchangeable (paragraphs 30A.12–30A.18)

30.5A If, at a measurement date, a currency is not exchangeable into another currency (as described in paragraphs 30A.2–30A.11), an entity shall estimate the spot exchange rate at that date. An entity's objective in estimating the spot exchange rate is to reflect the rate at which an orderly exchange transaction would take place at the measurement date between **market participants** under prevailing economic conditions.

Educational notes

Paragraph 30.5A is new in the third edition of the Standard. It reflects changes made to IAS 21 because some preparers had said they found it difficult to determine whether a currency is exchangeable into another currency, and what to do if it is not.

The new paragraph is supported by the Appendix to Section 30 which provides application guidance.

Exchangeability

30A.1 The purpose of this application guidance is to help entities assess whether a currency is exchangeable (see paragraphs 30A.2–30A.11) and to estimate the spot exchange rate when a currency is not exchangeable (see paragraphs 30A.12–30A.18).

Step 1—Assessing whether a currency is exchangeable

30A.2 A currency is exchangeable into another currency when an entity is able to obtain the other currency within a time frame that allows for a normal administrative delay and through a market or exchange mechanism in which an exchange transaction would create enforceable rights and obligations. An entity assesses whether a currency is exchangeable into another currency:

- (a) at a measurement date; and
- (b) for a specified purpose.

30A.3 If an entity is able to obtain no more than an insignificant amount of the other currency at the measurement date for the specified purpose, the currency is not exchangeable into the other currency.

30A.4 An entity might determine that a currency is not exchangeable into another currency, even though that other currency might be exchangeable in the other direction. For example, an entity might determine that currency PC is not exchangeable into currency LC, even though currency LC is exchangeable into currency PC.

Educational notes

An entity that follows Step 1 for a currency and determines that it is exchangeable does not need to estimate a spot rate, since it is able to obtain the other currency at a market rate.

Section 30 provides more detail on applying Step 1, covering:

- what a reasonable time frame is;
- whether the entity is able to obtain the other currency, and what it means to obtain a more than insignificant amount;
- which markets or exchange mechanisms to consider; and
- the purpose of obtaining the other currency.

Time frame

30A.5 A spot exchange rate is the exchange rate for immediate delivery. However, an exchange transaction might not always complete instantaneously because of legal or regulatory requirements, or for practical reasons such as public holidays. A normal administrative delay in obtaining the other currency does not preclude a currency from being exchangeable into that other currency. What constitutes a normal administrative delay depends on the facts and circumstances surrounding the exchange transaction.

Educational notes

The guidance in paragraph 30.5A recognises that in practice an exchange of currencies might not be instantaneous, and that the existence of a brief administrative delay would not mean an entity was prevented from treating a currency as exchangeable.

Example—Time frame

Ex 6 SME A has a subsidiary, SME B. SME A's functional and presentation currency is PC; SME B's functional currency is LC. The relevant authority in SME B's jurisdiction makes its presentation currency PC available to entities in exchange for local currency LC only after completion of an administrative process. The authority requires entities wishing to obtain PC to explain how they intend to use PC when submitting a request for PC. In usual circumstances, an entity obtains PC after three days—that is, three days is the time the authority needs, under its administrative process, to perform checks and provide PC.

SME A considers three days to be a normal administrative delay applying to a transaction to exchange LC for PC through this exchange mechanism. Subject to the other requirements in paragraphs 30A.2–30A.4, SME A considers LC to be exchangeable into PC if SME A is able to obtain PC within three days of requesting it.

Ability to obtain the other currency

30A.6 In assessing whether a currency is exchangeable into another currency, an entity shall consider its ability to obtain the other currency (either directly or indirectly), instead of its intention or decision to do so. For example, subject to the other requirements in paragraphs 30A.2–30A.11, regardless of whether the entity intends or decides to obtain currency PC, currency LC is exchangeable into currency PC if the entity is able either (directly) to exchange LC for PC, or (indirectly) to exchange LC for another currency (FC) and then exchange FC for PC.

Educational notes

The requirement to consider ability rather than intention works both ways: an entity would not classify a currency as exchangeable simply because it intended to exchange it, and conversely it would not classify a currency as not exchangeable simply because it intended to hold amounts in that currency rather than exchanging them.

Markets or exchange mechanisms

30A.7 In assessing whether a currency is exchangeable into another currency, an entity shall consider only markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations. Enforceability is a matter of law. Whether an exchange transaction in a market or exchange mechanism would create enforceable rights and obligations depends on the facts and circumstances surrounding the exchange transaction.

Educational notes

This paragraph, like paragraph 30A.6, requires an entity to be able to exchange a currency if it is to classify it as exchangeable. A notional exchangeability that is not enforceable is not enough for the currency to be treated as exchangeable.

Example—Markets or exchange mechanisms

Ex 7 SME X has a subsidiary, SME Y. SME X's functional and presentation currency is PC; SME Y's functional currency is LC. The relevant authority in SME Y's jurisdiction is unable to meet demand for PC and temporarily stops making PC available through the exchange mechanism it administers. In the absence of this exchange mechanism, individual resellers settle transactions to exchange LC for PC at an exchange rate that is not set by the authority. These exchange transactions do not create enforceable rights and obligations, and no other markets or exchange mechanisms exist in which a transaction to exchange LC for PC would create such rights and obligations.

In assessing whether LC is exchangeable into PC, SME X considers only markets or exchange mechanisms in which a transaction to exchange LC for PC would create enforceable rights and obligations. SME X concludes that LC is not exchangeable into PC because the exchange transactions with individual resellers do not create enforceable rights and obligations, and no other markets or exchange mechanisms exist in which a transaction to exchange LC for PC would create such rights and obligations.

Purpose of obtaining the other currency

- 30A.8 Exchange rates might vary depending on how the currency is to be used. For example, the relevant authorities of a jurisdiction might set a preferential exchange rate for imports of specific goods and a 'penalty' exchange rate for dividend payments to other jurisdictions.
- 30A.9 Accordingly, whether a currency is exchangeable into another currency could depend on the purpose for which an entity obtains (or hypothetically might need to obtain) the other currency. In assessing exchangeability, an entity shall assume its purpose in obtaining the other currency is:
- (a) to realise or settle individual foreign currency transactions, assets or liabilities when the entity reports foreign currency transactions in its functional currency (see paragraphs 30.6–30.11 and 30.14–30.16).
 - (b) to realise or settle its net assets or net liabilities when the entity uses a presentation currency other than its functional currency (see paragraphs 30.17–30.21). The entity's net assets might be realised by, for example, payment of dividends to its shareholders or disposal of the investment in the entity by its shareholders.
 - (c) to realise or settle its net investment in the foreign operation when the entity translates the results and financial position of a foreign operation into the presentation currency (see paragraphs 30.22–30.23). The entity's net investment in a foreign operation might be realised by, for example, receipt of dividends from the foreign operation or disposal of the investment in the foreign operation.
- 30A.10 An entity shall assess whether a currency is exchangeable into another currency separately for each purpose specified in paragraph 30A.9.

Educational notes

A jurisdiction might set preferential exchange rates to remove pressure on its balance of payments, for example if it wishes to deter capital remittances (such as dividend payments) to other jurisdictions but encourage imports of specific goods from those jurisdictions. If this applies to an entity's jurisdiction, paragraphs 30A.8–30A.10 set out the assumptions an entity is required to make about its purpose in obtaining the currency.

Example—Purpose of obtaining the other currency

Ex 8 SME X has a subsidiary, SME Y. SME X's functional and presentation currency is PC; SME Y's functional currency is LC. The relevant authority in SME Y's jurisdiction prevents entities from obtaining PC for purposes other than importing food and medicine.

In translating the results and financial position of SME Y, SME X assesses whether it is able to obtain PC for the purpose of realising its net investment in SME Y (paragraph 30A.9(c)). Because SME X is prevented from obtaining PC for this purpose, SME X concludes that LC is not exchangeable into PC. SME X's ability to obtain PC for the purpose of importing food and medicine is irrelevant to the assessment.

Ability to obtain only limited amounts of the other currency

30A.11 A currency is not exchangeable into another currency at the measurement date if, for a purpose specified in paragraph 30A.9, an entity is able to obtain no more than an insignificant amount of the other currency. For example, an entity with a functional currency of LC has liabilities denominated in currency FC. The entity assesses whether the total amount of FC it can obtain for the purpose of settling those liabilities is no more than an insignificant amount compared with the aggregated amount (the sum) of its liability balances denominated in FC.

Educational notes

Paragraph 30A.11 further supports the principle that an entity needs to be able to obtain meaningful amounts of a currency if it is to treat that currency as exchangeable. If the entity can exchange only an insignificant proportion of its LC balances into FC, it would be inappropriate to conclude that its LC is exchangeable.

Step 2—Estimating the spot exchange rate when a currency is not exchangeable (paragraph 30.5A)

30A.12 This Standard does not specify how an entity estimates the spot exchange rate when a currency is not exchangeable. In estimating the spot exchange rate to meet the objective in paragraph 30.5A, an entity is permitted to use either:

- (a) an observable exchange rate without adjustment (see paragraphs 30A.13–30A.17); or
- (b) another estimation technique (see paragraph 30A.18).

Educational notes

A consequence of a currency not being exchangeable is that there is no spot exchange rate available for the required purpose, so entities need to find a way of estimating the exchange rate to use. The Standard offers the options of using an observable rate without adjustment, or another estimation technique.

Using an observable exchange rate without adjustment

30A.13 Examples of an unadjusted observable exchange rate include:

- (a) a spot exchange rate for a purpose other than that for which an entity assesses exchangeability (see paragraphs 30A.14–30A.15); and
- (b) the first exchange rate at which an entity is able to obtain the other currency for the specified purpose after exchangeability of the currency is restored (the first subsequent exchange rate) (see paragraphs 30A.16–30A.17).

Using an observable exchange rate for another purpose

- 30A.14 A currency that is not exchangeable into another currency for one purpose might be exchangeable into that currency for another purpose. For example, an entity might be able to obtain a currency to import specific goods but not to pay dividends. In such situations, the entity might conclude that an observable exchange rate for another purpose meets the objective described in paragraph 30.5A.
- 30A.15 An observable exchange rate for another purpose might not reflect the prevailing economic conditions when, for example:
- (a) the rate includes an ‘incentive’ or ‘penalty’ set to encourage or deter entities from obtaining the other currency for particular purposes;
 - (b) an entity is able to obtain the other currency only for limited purposes (for example, to import emergency supplies);
 - (c) the rate is set through regular interventions by the relevant authorities; or
 - (d) the rate is unchanged over time instead of being updated daily (or more frequently).

Educational notes

An observable rate is convenient to use where it is available but, as explained in paragraph 30A.14, it will not always be appropriate to use it. The objective in paragraph 30.5A requires the entity to determine a rate that reflects the rate at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic conditions. Paragraph 30A.15 lists examples of situations where an observable rate might not reflect prevailing economic conditions, meaning it would not meet the objective and would not be an acceptable rate to use.

Example—Using an observable exchange rate for another purpose

Ex 9 SME X has a subsidiary, SME Y. SME X’s functional and presentation currency is PC; SME Y’s functional currency is LC. At 31 December 20X1 the relevant authority in SME Y’s jurisdiction prevents entities from obtaining PC for the purpose of realising a net investment in an entity operating in that jurisdiction. Other than that restriction, entities are able to obtain PC and the LC:PC exchange rate is free-floating. Only one exchange rate applies to transactions for exchanges of LC for PC; it is updated several times a day.

At the measurement date of 31 December 20X1, SME X is unable to obtain PC to realise its net investment in SME Y. Therefore, SME X concludes that LC is not exchangeable into PC.

Because SME X concludes that LC is not exchangeable into PC, SME X is required to estimate the spot exchange rate that meets the objective in paragraph 30.5A.

Applying paragraphs 30A.8–30A.10, SME X considers whether it might use the observable LC:PC exchange rate for the purpose of realising a net investment in an entity. To do so, it assesses whether that observable exchange rate meets the objective in paragraph 30.5A and considers the following factors listed in paragraph 30A.15:

- (a) *whether the rate includes an incentive or penalty to encourage or deter entities from obtaining the currency for particular purposes*—SME X concludes that no such incentives or penalties appear to be in place;
- (b) *whether the entity can obtain the other currency only for limited purposes*—SME X concludes that it is able to obtain PC for any transaction other than a transaction that would result in the realisation of its net investment in SME Y;
- (c) *whether the rate is set through regular interventions by the relevant authorities*—SME X concludes that the observable exchange rate is free-floating; and
- (d) *the frequency with which exchange rates are updated*—SME X concludes that the observable exchange rate is updated several times a day.

Considering these factors, SME X determines that the observable LC:PC exchange rate meets the objective in paragraph 30.5A because none of the factors are in place that would indicate the rate does not reflect prevailing economic conditions. Therefore, SME X may use that observable exchange rate as the estimated spot exchange rate when it translates the results and financial position of SME Y.

Note that this conclusion applies in the fact pattern given but the list of examples in 30A.15 is not exhaustive and it is possible that in other circumstances there could be additional facts that would indicate that a rate did not reflect prevailing economic conditions.

Using the first subsequent exchange rate

30A.16 A currency that is not exchangeable into another currency at the measurement date for a specified purpose might subsequently become exchangeable into that currency for that purpose. In such situations, an entity might conclude that the first subsequent exchange rate meets the objective described in paragraph 30.5A.

30A.17 The first subsequent exchange rate might not reflect the prevailing economic conditions when, for example:

- (a) the date at which exchangeability is restored is long after the measurement date; or
- (b) an economy is subject to hyperinflation or high inflation and prices often change quickly, perhaps several times a day.

Educational notes

The first subsequent exchange rate is the first rate that becomes available after a currency which was not exchangeable becomes exchangeable. Using the first subsequent exchange rate is an alternative way of obtaining an observable exchange rate without adjustment and might be suitable if there is no exchange rate for another purpose available or if an exchange rate for another purpose does not meet the objective in paragraph 30.5A.

Example—Using the first subsequent exchange rate

Ex 10 SME X has a subsidiary, SME Y. SME X's functional and presentation currency is PC; SME Y's functional currency is LC. At 31 December 20X1 the jurisdiction in which SME Y operates is subject to hyperinflation. The relevant authority in SME Y's jurisdiction prevents entities from obtaining PC for the purpose of realising a net investment in an entity operating in that jurisdiction. However, from 30 April 20X2, the authority allows entities to obtain PC for that purpose.

At the measurement date of 31 December 20X1, SME X is unable to obtain PC to realise its net investment in SME Y. Therefore, SME X concludes that LC is not exchangeable into PC.

Because SME X concludes that LC is not exchangeable into PC, SME X is required to estimate the spot exchange rate in a way that meets the objective in paragraph 30.5A.

Applying paragraphs 30A.12–30A.13 and 30A.16–30A.17, SME X considers whether it might use the first exchange rate at which it is able to obtain the other currency after exchangeability of the currency is restored (first subsequent exchange rate). To do so, it assesses whether that first subsequent exchange rate meets the objective in paragraph 30.5A and considers:

- (a) *the time between the measurement date and the date at which exchangeability is restored*—SME X concludes that exchangeability is restored four months after the measurement date; and
- (b) *the inflation rate*—SME X concludes that the jurisdiction SME Y operates in is subject to hyperinflation.

Considering these factors, SME X determines that the first subsequent exchange rate does not reflect the prevailing economic conditions at the measurement date because there is a long time between the measurement date and the point exchangeability is restored, and the economy is subject to hyperinflation. Therefore, the first subsequent exchange rate does not meet the objective in paragraph 30.5A for the purpose of realising SME X's net investment in SME Y. However, SME X could adjust that rate as necessary to estimate a rate that meets the objective in paragraph 30.5A for realising its net investment in SME Y, using paragraph 30A.19.

Using another estimation technique

30A.18 An entity using another estimation technique is permitted to use any observable exchange rate—including rates from exchange transactions in markets or exchange mechanisms that do not create enforceable rights and obligations—and adjust that rate, as necessary, to meet the objective described in paragraph 30.5A.

Educational notes

Paragraph 30A.18 provides a way forward for entities that find they cannot identify a suitable observable exchange rate to use without adjustment. Example 10 shows an entity that considers using the first exchange rate at which exchangeability is restored, and concludes this is not acceptable. However, the example goes on to describe how an entity can adjust a rate so that it does meet the objective in paragraph 30.5A.

Reporting foreign currency transactions in the functional currency

Initial recognition

- 30.6 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:
- (a) buys or sells goods or services whose price is denominated in a foreign currency;
 - (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
 - (c) otherwise acquires or disposes of **assets**, or incurs or settles **liabilities**, denominated in a foreign currency.

Educational notes

A foreign currency is a currency other than the functional currency of the entity. When an entity enters into foreign currency transactions, it is exposed to changes in value of the foreign currency in relation to the functional currency.

What if an entity keeps its accounting records in a foreign currency?

If an entity kept its accounting records in a foreign currency, all amounts would need to be translated into the functional currency in accordance with paragraphs 30.6–30.11. The effect of doing so would be the same as if it had been recording the items initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate and non-monetary items measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition, while non-monetary items measured at fair value are translated using the exchange rate at the date when the fair value was determined (see paragraph 30.9).

When accounting records are kept in a foreign currency, translation into the functional currency in accordance with paragraphs 30.6–30.11 would be required before an entity translated its financial statements into a presentation currency of choice or into a group presentation currency, if applicable (see paragraph 30.17).

30.7 An entity shall record a foreign currency transaction, 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.

Educational notes

On initial recognition, the amount recognised in the foreign currency is determined in conjunction with other relevant sections of the Standard before it is translated into the functional currency.

Recording a transaction in the functional currency does not change the essential characteristics of the assets and liabilities measured but an entity must measure assets and liabilities denominated in a foreign currency in the functional currency by applying the currency exchange rate for immediate delivery—the spot exchange rate.

Example—Selling goods in a foreign currency (paragraph 30.6(a))

Ex 11 An SME with a functional currency of CU sells inventory with a carrying amount of CU10,000 to a customer on credit for FCU30,000.¹ The spot exchange rate when the revenue is recognised in accordance with Section 23 *Revenue from Contracts with Customers* is CU1 = FCU2.

On initial recognition the sale is accounted for as follows:

Dr	Trade receivables—Asset	CU15,000	
	Cr	Profit or loss—Revenue from the sale of goods	CU15,000

To recognise revenue from the sale of inventory on credit (FCU30,000 ÷ 2).

¹ In this example, and in other examples in this module, monetary amounts are denominated in 'currency units' (CU) or 'foreign currency units' (FCU).

The derecognition of the inventory sold is accounted for as follows:

Dr	Profit and loss—Cost of goods sold	CU10,000	
	Cr Inventories—Asset		CU10,000

To recognise the cost of goods sold (carrying amount).

Example—Borrowing money in a foreign currency (paragraph 30.6(b))

Ex 12 An SME with a functional currency of CU borrows FCU100,000 from a bank when the spot exchange rate is CU1 = FCU2.5.

The loan is recorded on initial recognition as follows:

Dr	Cash—Asset	CU40,000	
	Cr FCU loan payable—Liability		CU40,000

To recognise the borrowing transaction (FCU100,000 ÷ 2.5).

Example—Buying a machine in a foreign currency (paragraph 30.6(c))

Ex 13 An SME with a functional currency of CU buys a machine (property, plant and equipment) from an overseas supplier for cash of FCU10,000. The spot exchange rate is FCU1 = CU2 on the date the machine is initially recognised.

The machine is recorded on initial recognition as follows:

Dr	Property, plant and equipment—Machine	CU20,000	
	Cr Cash—Asset		CU20,000

To recognise the acquisition of machinery for cash (FCU10,000 × 2).

30.8 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with this Standard. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Educational notes

The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with the relevant section of the Standard. For example, an entity is required to recognise revenue from the sale of goods in a foreign currency on the date that the conditions in paragraph 23.10 of Section 23 are satisfied, using the spot exchange rate at that date.

Use of an average rate

Management should apply its judgement in deciding whether it is appropriate to use an average rate for foreign currency transactions based on the entity's own specific circumstances. An average rate is usually appropriate only when the exchange rate does not fluctuate significantly and the entity has a large number of foreign currency transactions—when such transactions are frequent, translation at the actual exchange rate at the dates of the numerous revenues, expenses, gains and losses may be very time consuming. Section 30 permits management to use an average rate that approximates the actual rate.

If management decides to use average rates to approximate actual rates, it needs to decide whether it is appropriate to derive an average rate for the entire year, or for each month, or each week (and so on). For example, if exchange rates are relatively stable over a period of one month, the average exchange rate for that month can be used as an approximation to the daily rate. However, if exchange rates are volatile, it may be more appropriate to calculate an average rate for a shorter period such as a week or a few days in that period (or to use the actual rate for each transaction in the period of volatility). Whatever period is chosen, the intention is that the carrying amount of non-monetary assets is not materially different from what it would have been if actual rates had been used for translation. The actual rates should be used if a material difference is expected to arise compared to average rates. Consequently, if the entity has any one-off large transactions, it should use the actual rate for those transactions.

There are a number of methods of calculating an average rate, from simple monthly or quarterly averages to more sophisticated methods using appropriate weighting that reflect changes both in exchange rates and in the volume of business. A simple annual or quarterly average rate assumes that income and expenses arise evenly over the year (or quarter). If more sales are made and more expenses are incurred in particular months, it would be better to use a weighted average rate that takes account of periods that may have more activity.

30.8A When an entity pays or receives consideration in advance in a foreign currency, it recognises a non-monetary asset or non-monetary liability. The exchange rate to be used on the initial recognition of the related asset, expense or income (or part of it) is the exchange rate at the date on which the entity initially recognised the non-monetary asset or the non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration.

Educational notes

This paragraph was added to Section 30 in the Standard. It addresses the situation in which an entity makes a sale or purchase and receives or pays consideration before the related goods or services are provided or received. The exchange rate used for the non-monetary asset or liability relating to the advance payment or receipt is the exchange rate when the payment was made. Because these are non-monetary assets and liabilities they are not subsequently retranslated—see paragraph 30.9(b).

Example—A single advance payment for the purchase of a single item of property, plant and equipment

Ex 14 On 1 March 20X1, SME A entered into a contract with a supplier to purchase a machine for use in its business. Under the terms of the contract, SME A pays the supplier a fixed purchase price of FCU1,000 on 1 April 20X1. On 15 April 20X1, SME A takes delivery of the machine.

SME A initially recognises a non-monetary asset translating FCU1,000 into its functional currency at the spot exchange rate between the functional currency and the foreign currency on 1 April 20X1. Applying paragraph 30.9(b) of the Standard, SME A does not update the translated amount of that non-monetary asset.

On 15 April 20X1, SME A takes delivery of the machine. SME A derecognises the non-monetary asset and recognises the machine as property, plant and equipment in accordance with Section 17. On initial recognition of the machine, SME A recognises the cost of the machine using the exchange rate at the date of the transaction, which is 1 April 20X1 (the date of initial recognition of the non-monetary asset).

Example—Multiple receipts for revenue recognised at a single point in time

Ex 15 On 1 June 20X2, SME B entered into a contract with a customer to deliver goods on 1 September 20X2. The total fixed contract price is an amount of FCU100, of which FCU40 is due and received on 1 August 20X2 and the balance is receivable on 30 September 20X2.

SME B initially recognises a non-monetary contract liability translating FCU40 into its functional currency at the spot exchange rate between the functional currency and the foreign currency on 1 August 20X2. Applying paragraph 30.9(b) of the Standard, SME B does not update the translated amount of that non-monetary liability.

Applying paragraph 23.49 of Section 23, SME B recognises revenue on 1 September 20X2, the date on which it transfers the goods to the customer. SME B determines that the date of the transaction for the revenue relating to the advance consideration of FCU40 is 1 August 20X2 because this was the date on which the advance consideration was due and received. Applying paragraph 30.8A of the Standard, SME B determines that the date of the transaction for the remainder of the revenue is 1 September 20X2.

On 1 September 20X2, SME B:

- (a) derecognises the contract liability of FCU40 and recognises revenue using the exchange rate on 1 August 20X2; and
- (b) recognises revenue of FCU60 and a corresponding receivable using the exchange rate on 1 September 20X2.

The receivable of FCU60 recognised on 1 September 20X2 is a monetary item. SME B updates the translated amount of the receivable until the receivable is settled.

Example—Multiple payments for purchases of services over a period of time

Ex 16 On 1 May 20X3, SME C entered into a contract with a supplier for services. The supplier will provide the services to SME C evenly over the period from 1 July 20X3 to 31 December 20X3. The contract requires SME C to pay the supplier FCU200 on 15 June 20X3 and FCU400 on 31 December 20X3. SME C has determined that, for this contract, the payment of FCU200 on 15 June 20X3 relates to the services to be received in the period 1 July–31 August 20X3, and the payment of FCU400 on 31 December 20X3 relates to the services to be received in the period 1 September–31 December 20X3.

SME C initially recognises a non-monetary asset translating FCU200 into its functional currency at the spot exchange rate between the functional currency and the foreign currency on 15 June 20X3.

In the period 1 July–31 August 20X3, SME C derecognises the non-monetary asset and recognises an expense of FCU200 in profit or loss as it receives the services from the supplier. SME C determines that the date of the transaction for the expense related to the advance consideration of FCU200 is 15 June 20X3 (the date of initial recognition of the non-monetary asset).

In the period 1 September–31 December, SME C recognises the expense in profit or loss as it receives the services from the supplier. In principle, the dates of the transaction are each day in the period 1 September–31 December 20X3. However, if exchange rates do not fluctuate significantly, SME C may use a rate that approximates the actual rates as permitted by paragraph 30.8. If that is the case, SME C may, for example, translate each month's expense of FCU100 ($\text{FCU}400 \div 4$) into its functional currency using the average exchange rate for each month for the period 1 September–31 December.

As SME C recognises the expense in the period 1 September–31 December, it recognises a corresponding liability in respect of its obligation to pay the supplier. Because the liability is a monetary item, SME C updates the translated amount of the liability until the liability is settled.

Example—Multiple receipts for revenue recognised at multiple points in time

Ex 17 On 1 January 20X4, SME D enters into a contract to sell two products to a customer. SME D transfers one product on 1 March 20X4 and the second on 1 June 20X4. As required by the contract, the customer pays a fixed purchase price of FCU1,000, of which FCU200 is due and received in advance on 31 January 20X4 and the balance is due and received on 1 June 20X4.

Applying Section 23, SME D allocates FCU450 of the transaction price to the first product and FCU550 to the second product. SME D has determined that for this contract, the consideration of FCU200 received on 31 January 20X4 relates to the first product transferred on 1 March 20X4. On transfer of that product to the customer, SME D has an unconditional right to FCU250 of the remaining consideration.

The spot exchange rates are:

31 January 20X4 1:1.15

1 March 20X4 1:1.7

1 June 20X4 1:1.9

SME D accounts for the foreign currency aspects of the contract with several journal entries.

SME D receives the advance payment of FCU200 on 31 January 20X4, which it translates into its functional currency (LCU) using the exchange rate at 31 January 20X4 as follows:

Dr	Cash (FCU200)	LCU300	
	Cr	Contract liability	LCU300

Applying paragraph 30.9(b) of the Standard, SME D does not update the translated amount of the non-monetary contract liability.

SME D then transfers the first product with a transaction price of FCU450 on 1 March 20X4. SME D derecognises the contract liability and recognises revenue of LCU300. SME D recognises the remaining revenue of FCU250 relating to the first product and a corresponding receivable, both of which it translates at the exchange rate at the date that it initially recognises the remaining revenue of FCU250 (on 1 March 20X4) as follows:

Dr	Contract liability (FCU200)	LCU300	
Dr	Receivable (FCU250)	LCU425	
	Cr	Revenue	LCU725

Because the receivable of FCU250 is a monetary item, SME D updates the translated amount of the receivable until the receivable is settled (on 1 June 20X4). At 1 June 20X4, the receivable of FCU250 is equivalent to LCU475. As required by paragraph 30.10, SME D recognises an exchange gain of LCU50 in profit or loss as follows:

Dr	Receivable	LCU50	
	Cr	Foreign exchange gain	LCU50

SME D transfers the second product with a transaction price of FCU550 on 1 June 20X4. SME D recognises revenue of FCU550 using the exchange rate at the date of the transaction, which is the date that SME D first recognises this part of the transaction in its financial statements (1 June 20X4).

SME D also receives the remaining consideration of FCU800 on 1 June 20X4. FCU250 of the consideration received settles the receivable of FCU250 arising on the transfer of the first product. SME D translates the cash at the exchange rate at 1 June 20X4 as follows:

Dr	Cash (FCU800)	LCU1,520	
	Cr	Receivable (FCU250)	LCU475
	Cr	Revenue (FCU550)	LCU1,045

Reporting at the end of the subsequent reporting periods

30.9 At the end of each **reporting period**, an entity shall:

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

Educational notes

At the end of each accounting period, the carrying amount of an item is determined in the foreign currency applying other relevant sections of the Standard before translation into the functional currency. For example, if an item of investment property is denominated in a foreign currency (overseas property) and its fair value can be measured reliably, the fair value must be determined annually in the foreign currency in accordance with Section 12 *Fair Value Measurement*. The fair value is then translated into the functional currency in accordance with paragraph 30.9(c).

Translation of monetary items

Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency (see the definition of monetary items in the Glossary). Examples include cash; trade receivables; trade payables; loans; tax assets and tax liabilities; pensions and other employee benefits to be paid in cash; provisions to be settled in cash; and cash dividends recognised as an asset or liability.

Not all financial assets should be treated as monetary items. For example, an investment in an equity instrument is not a monetary item because the asset will not be received in a fixed or determinable amount of cash.

All monetary items in foreign currency are translated using the closing rate. The closing rate is the spot exchange rate at the end of the reporting period. Even if a foreign currency transaction will be settled at a predetermined contracted exchange rate, Section 30 does not permit the contracted rate to be used instead.

Translation of non-monetary items

Non-monetary items are all items other than monetary items. Examples of non-monetary items include amounts prepaid for goods and services (such as prepaid rent); goodwill; intangible assets; inventories; property, plant and equipment; an investment in an equity instrument (such as investments in associates); shareholders' equity and provisions to be settled by the delivery of a non-monetary asset. From the third edition of the Standard, advance consideration is treated as a separate type of non-monetary item with specific requirements included in paragraph 30.8A.

The translation of non-monetary items depends on whether they are measured at historical cost or at fair value at the reporting date.

Non-monetary items measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the initial transaction. Because assets are recorded at historical cost, no retranslation of the asset will generally be required at subsequent reporting dates. However, if such an asset is impaired, translation will be required because the recoverable amount is translated at the exchange rate prevailing at the date when the recoverable amount was determined.

Non-monetary assets measured at fair value in a foreign currency are translated using the exchange rate at the date when the fair value is determined.

The carrying amount of some items is determined by comparing two or more amounts. For example, Section 13 *Inventories* requires inventories to be measured at the lower of cost and estimated selling price less costs to complete and sell. Section 27 *Impairment of Assets* requires assets within its scope, when there is an indication that they are impaired, to be measured at the lower of carrying amount and recoverable amount (the higher of fair value less costs to sell and its value in use).

When an asset that is within the scope of Section 27 (other than inventories) is measured in a foreign currency, the carrying amount is the lower of:

- the carrying amount translated at the exchange rate at the date when that amount was determined (the exchange rate on the date of initial recognition for an item measured in terms of historical cost); and
- its recoverable amount (the higher of its estimated selling price less costs to sell, and its value in use—at present value—translated at the exchange rate at the date when that value was determined, which is likely to be the closing rate at the end of the reporting period).

The effect of comparing the two amounts may be that an impairment loss is recognised in the functional currency but would not be recognised in the foreign currency, or vice versa.

30.10 An entity shall recognise, in **profit or loss** in the period in which they arise, exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous periods, except as described in paragraph 30.13.

Educational notes

When a monetary item arises from a foreign currency transaction and the exchange rate changes between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each period up to the date of settlement is determined by the change in exchange rates in each period.

Example—Buying goods on credit in a foreign currency

Ex 18 On 24 December 20X1, an SME with a functional currency of CU buys raw materials from a supplier on credit for FCU100,000. The SME pays the supplier on 17 January 20X2. The SME has a financial year-end of 31 December 20X1.

The spot exchange rates are as follows:

- 24 December 20X1: CU2 = FCU1
- 31 December 20X1: CU2.1 = FCU1
- 17 January 20X2: CU2.05 = FCU1

Initial recognition

The purchase is recorded on initial recognition on 24 December 20X1 as follows:

Dr	Inventories—Raw materials	CU200,000	
	Cr Trade payable		CU200,000

To recognise the acquisition of raw materials (FCU100,000 × 2).

Year ended 31 December 20X1

On 31 December 20X1 if the raw materials have not been used, sold or impaired they will still be recognised at CU200,000. However, the trade payable is translated at closing rates to CU210,000 ($FCU100,000 \times 2.1$):

Dr	Profit or loss—Exchange difference	CU10,000	
	Cr	Trade payable	CU10,000

To recognise the difference arising on translating a monetary item at a rate different from that at which it was translated on initial recognition (($FCU100,000 \times 2.1$ closing rate) – ($FCU100,000 \times 2$)).

On 17 January 20X2

On 17 January 20X2 the trade payable is settled at the exchange rate on that date at CU205,000 ($FCU100,000 \times 2.05$):

Dr	Trade payable	CU210,000	
	Cr	Profit or loss—Exchange difference	CU5,000
	Cr	Cash	CU205,000

To recognise the exchange difference arising on translating a monetary item (($FCU100,000 \times 2.05$) – ($FCU100,000 \times 2.1$)), and the settlement of that monetary item.

Example—Foreign currency loan payable

Ex 19 On 1 January 20X1, a bank transfers FCU5,000 to an SME in return for a promise to pay fixed interest of 8% per year for two years (due at the end of each year of the loan period, 31 December) and a payment of FCU5,000 at the end of the two-year period.

At the inception of the loan 8% is the market rate for similar two-year fixed-interest FCU denominated loans.

The SME's functional currency is CU.

Exchange rates over the loan are (in this example, average rates are determined on a monthly average basis):

- 1 January 20X1: CU1 = FCU5
- 31 December 20X1: CU1 = FCU5.1
- 31 December 20X2: CU1 = FCU4.8

The average exchange rate for 20X1 is CU1 = FCU5.06. The average exchange rate for 20X2 is CU1 = FCU4.9. In this example, the difference between applying the average rate to the interest charges and applying the actual rate is below the SME's materiality threshold.

The loan balance (which is a monetary item) is translated at the spot exchange rate at the year-end date. Interest is translated at the average rate (because in this example, it approximates the actual rate).

Because the interest is at a market rate for a similar two year loan, in accordance with Section 11, the SME measures the loan on initial recognition at the transaction price (FCU5,000) translated into the functional currency.

Because there are no transaction costs, the effective interest rate (which is computed in the currency in which the loan is denominated (FCU)) is 8%, as shown here:

<i>Time</i>	<i>Carrying amount at 1 January FCU</i>	<i>Interest at 8%^(a) FCU</i>	<i>Cash outflow FCU</i>	<i>Carrying amount at 31 December FCU</i>
20X1	5,000	400	(400)	5,000
20X2	5,000	400	(5,400)	–

(a) The effective interest rate of 8% is the rate that discounts the expected cash flows on the loan to the initial carrying amount:
 $CU400 \div 1.08 + CU5,400 \div (1.08)^2 = CU5,000$. Discussion of effective interest rate can be found in Section 11 *Financial Instruments*.

The journal entries are:

Initial recognition

On 1 January 20X1, the loan is recorded on initial recognition as follows:

Dr	Cash	CU1,000	
	Cr	Loan payable—Financial liability	CU1,000

To recognise the borrowing transaction (FCU5,000 ÷ 5).

Year ended 31 December 20X1

In 20X1, the SME records interest expense as follows:

Dr	Profit or loss—Interest expense	CU79	
	Cr	Loan payable—Financial liability	CU79

To recognise interest on the loan payable in 20X1 (FCU400 ÷ 5.06).

On 31 December 20X1, the year's interest is paid and the following journal entry is made:

Dr	Loan payable—Financial liability	CU79	
	Cr	Cash	CU78
	Cr	Profit or loss—Exchange difference	CU1

To recognise the payment of 20X1 interest on the financial liability (FCU400 ÷ 5.1).

At 31 December 20X1, the loan is recorded at CU980 (FCU5,000 ÷ 5.1).

An exchange gain of CU20 arises, which is due to the difference between CU980 (calculation: FCU5,000 ÷ 5.1) recorded at 31 December 20X1 and the loan balance (CU1,000).

Consequently, a further journal entry on 31 December 20X1 is:

Dr	Loan payable—Financial liability	CU20	
	Cr	Profit or loss—Exchange difference	CU20

To recognise the difference arising on translating the monetary item at a rate different from that at which it was translated on initial recognition (calculation: CU980 – CU1,000).

Year ended 31 December 20X2

In 20X2 the SME records interest expense as follows:

Dr	Profit or loss—Interest expense	CU82	
	Cr	Loan payable—Financial liability	CU82

To recognise interest on the loan payable in 20X2 (FCU400 ÷ 4.9).

At 31 December 20X2 the loan is fully repaid (last interest payment plus principal). An exchange loss of CU63 arises due to the difference between the CU1,125 (cash outflow of principal and interest of FCU5,400 ÷ 4.8) paid on 31 December 20X2 and the loan balance adjusted for the interest of CU1,062 (= CU980 + CU82). On 31 December 20X2, when annual interest and the principal are paid, the following journal entry is made:

Dr	Loan payable—Financial liability	CU1,062	
Dr	Profit or loss—Exchange difference	CU63	
	Cr	Cash	CU1,125

To recognise the payment of 20X2 interest (FCU400 ÷ 4.8) and the settlement of the loan (FCU5,000 ÷ 4.8).

Example—Overseas investment property

Ex 20 On 1 June 20X0, an SME based in Country A with a functional currency of CU buys an investment property in Country B with local currency FCU for FCU500,000.

The fair value of the investment property is reliably measurable in FCU without undue cost or effort on an ongoing basis. Consequently, in accordance with Section 16 *Investment Property*, the SME measures its investment property, after initial recognition, at fair value through profit or loss.

The SME has a year-end of 31 December.

The spot exchange rates and fair values of the investment property (FVIP) are as follows:

- 1 June 20X0: CU1 = FCU1.1 and FVIP = FCU500,000
- 31 December 20X0: CU1 = FCU1.05 and FVIP = FCU520,000
- 31 December 20X1: CU1 = FCU1.2 and FVIP = FCU540,000

On 1 April 20X2 the investment property is sold for FCU570,000 when the exchange rate is CU1 = FCU1.1.

Initial recognition

The purchase is recorded on 1 June 20X0, as follows:

Dr	Investment property (cost)	CU454,545	
	Cr	Cash	CU454,545

To recognise the acquisition of the investment property (FCU500,000 ÷ 1.1).

Year ended 31 December 20X0

On 31 December 20X0, the investment property is measured at CU495,238 (FCU520,000 ÷ 1.05). The journal entries are:

Dr	Investment property	CU40,693	
	Cr	Profit or loss (fair value gain—investment property)	CU40,693

To recognise the increase in the fair value of the investment property in 20X0 ((FCU520,000 ÷ 1.05) – (FCU500,000 ÷ 1.1)).

The change in fair value in CU includes the foreign exchange gain arising on the change in exchange rate from CU1 = FCU1.1 to CU1 = FCU1.05 on the opening FCU carrying amount of the property of FCU500,000. This exchange gain is an element of the change in fair value that is recognised in profit or loss for the period. In addition, the SME has to comply with the requirement of paragraph 30.25(a), that is, to disclose the amount of exchange difference recognised in profit or loss during the period. Example 30 illustrates this disclosure.

Year ended 31 December 20X1

On 31 December 20X1, the investment property is measured at CU450,000 ($\text{FCU}540,000 \div 1.2$).

The journal entries are:

Dr	Profit or loss (fair value loss—investment property)	CU45,238	
	Cr	Investment property	CU45,238

To recognise the decrease in fair value of the investment property in 20X1 ($(\text{FCU}540,000 \div 1.2) - (\text{FCU}520,000 \div 1.05)$).

The change in fair value in CU includes the foreign exchange loss arising on the change in exchange rate from $\text{CU}1 = \text{FCU}1.05$ to $\text{CU}1 = \text{FCU}1.2$ on the opening carrying amount in FCU of the property of FCU520,000. This exchange loss is an element of the change in fair value that is recognised in profit or loss for the period. As noted above, though not accounted for separately, the exchange loss has to be disclosed to comply with paragraph 30.25(a) (see Example 30 for an illustration of this disclosure).

Derecognition

On 1 April 20X2 the investment property is sold for CU518,182 ($\text{FCU}570,000 \div 1.1$).

The journal entries are:

Dr	Cash	CU518,182	
	Cr	Profit or loss (fair value gain—investment property)	CU68,182
	Cr	Investment property	CU450,000

To recognise the sale of overseas investment property ($\text{FCU}570,000 \div 1.1$) and respective gain ($(\text{FCU}570,000 \div 1.1) - (\text{FCU}540,000 \div 1.2)$).

The change in fair value in CU includes the foreign exchange gain arising on the change in exchange rate from $\text{CU}1 = \text{FCU}1.2$ to $\text{CU}1 = \text{FCU}1.1$ on the opening carrying amount in FCU of FCU540,000. This exchange gain is an element of the change in fair value in profit or loss for the period up to the sale.

A foreign exchange gain is possible even if there is an overall decrease in the fair value of investment property (or vice versa). For example, if the foreign currency strengthened against the functional currency there would be an exchange gain on the opening carrying amount of the investment property in the period. However, if the fair value of the investment property fell significantly in the year, this would more than offset the exchange gain. The net change in fair value is recognised in the profit or loss account in any case.

For further details about investment properties measured on a fair value basis, see paragraph 16.7.

30.11 When another section of this Standard requires a gain or loss on a non-monetary item to be recognised in **other comprehensive income**, an entity shall recognise any exchange component of that gain or loss in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, an entity shall recognise any exchange component of that gain or loss in profit or loss.

Net investment in a foreign operation

30.12 An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraph 30.13. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Educational notes

An entity's net investment in a foreign operation is the amount of the entity's interest in the net assets of that operation.

The term 'foreseeable future' used in paragraph 30.12 is not defined in the Standard. The SME's intentions regarding the settlement of the monetary item are assessed and judgement may need to be applied in determining whether settlement is expected. For a monetary item that is receivable from, or payable to, a foreign operation to be part of the entity's net investment, management of the entity should view the monetary item as being part of the entity's long-term investment in that foreign operation and should not expect settlement of the monetary item to take place. Accordingly, a loan repayable on demand might be part of the entity's net investment if neither party to the loan intends or expects that repayment will be made. In addition, a long-term loan with a specified maturity would not qualify to be treated as being part of the net investment merely because it is of a long duration, unless management has expressed its intention to renew the loan at maturity and the foreign operation does not expect to make a repayment.

Trade receivables and trade payables with a foreign operation are not included as part of the entity's net investment in that foreign operation even if they are outstanding for a long period or if a minimum balance is always outstanding.

The entity that has a monetary item receivable from or payable to a foreign operation may be any subsidiary of the group; for example, if an entity has two overseas subsidiaries (A and B) and Subsidiary A grants a loan to Subsidiary B. Subsidiary A's loan receivable from Subsidiary B may be considered part of the entity's net investment in Subsidiary B if settlement of the loan is neither planned nor likely to occur in the foreseeable future. For the purposes of this assessment, it makes no difference whether Subsidiary A is overseas.

An intragroup loan that is considered part of the net investment in a foreign operation should be assessed periodically to ensure that it still meets the requirements in paragraph 30.12. For example, management's expectations and intent regarding the repayment of the loan may alter because of a change in circumstances.

Section 30 explains when a monetary item is a part of an entity's net investment in a foreign operation. Section 11 addresses the accounting treatment for a hedge of a net investment in a foreign operation.

30.13 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in 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 include the foreign operation and the reporting entity (for example, **consolidated financial statements** when the foreign operation is a subsidiary), such exchange differences shall be recognised in other comprehensive income and reported as a component of equity. They shall not be recognised in profit or loss on disposal of the net investment.

Educational notes

Paragraph 30.13 would apply regardless of whether the monetary item that forms part of a reporting entity's net investment is denominated in the functional currency of the reporting entity, the functional currency of the foreign operation, or in a different currency.

In examples 21–24, the presentation currency means the currency in which the financial statements are presented (see paragraph 30.17).

Examples—Parent makes foreign currency loan to foreign subsidiary

Ex 21 On 1 January 20X0, an SME parent entity (whose functional currency is CU) made a FCU20,000 loan to a foreign SME subsidiary (whose functional currency is FCU). The loan bears interest at a market rate payable annually at the end of each calendar year. The parent has informed the subsidiary that it does not expect to demand repayment and the subsidiary does not expect to repay the loan for the foreseeable future. The amortised cost of the loan at each reporting date is FCU20,000. The parent entity regards its loan to its foreign subsidiary as part of its net investment in that foreign operation.

The exchange rates are as follows:

- 1 January 20X0: CU1 = FCU2
- 31 December 20X0: CU1 = FCU2.1

Parent's separate financial statements (see paragraphs 9.24–9.27)

Initial recognition

On 1 January 20X0, the foreign currency loan receivable is recorded as follows:

Dr	Loan to subsidiary (long-term loan)	CU10,000	
	Cr	Cash	CU10,000

To recognise the foreign currency loan to subsidiary (FCU20,000 ÷ FCU2).

Subsequent measurement

On 31 December 20X0, the foreign currency loan receivable is translated as follows:

Dr	Profit or loss—Exchange difference	CU476	
	Cr	Loan to subsidiary (long-term loan)	CU476

To translate the foreign currency loan to subsidiary (FCU20,000 ÷ FCU2.1 = CU9,524 – CU10,000).

The parent adopts an accounting policy for its investments in subsidiaries at cost less impairment in its separate financial statements.

Subsidiary's financial statements, if prepared

Initial recognition

On 1 January 20X0, the loan payable is recorded as follows:

Dr	Cash	FCU20,000	
	Cr	Loan from parent (long-term payable)	FCU20,000

To recognise the loan from its parent.

At 31 December 20X0, the subsidiary does not remeasure the FCU-denominated loan from its parent because the loan is denominated in the subsidiary's functional currency and its financial statements are presented in FCU.

Group's consolidated financial statements (assuming presentation currency is CU)

On 31 December 20X0, to prepare the consolidated financial statements, the subsidiary's financial information is translated into CU (the presentation currency of the parent's consolidated financial statements). CU476 (the part of the resulting exchange difference that is attributable to translating the loan from the parent: $((FCU20,000 \div FCU2) - (FCU20,000 \div FCU2.1))$) is presented in other comprehensive income in accordance with paragraph 30.18.

In preparing consolidated financial statements, the intra-group balances and transactions, including income, expenses and dividends, are eliminated in full (see paragraph 9.15). Consequently, on consolidation, the CU9,524 long-term loan (in the parent's accounting records: $FCU20,000 \div FCU2.1$) and CU9,524 loan payable (in the subsidiary's translated accounting records), are eliminated in full.

The exchange difference arising on the monetary item that forms part of the reporting entity's net investment in a foreign operation (the CU476 that is presented in profit or loss in the parent's separate financial statements) is presented in other comprehensive income (see paragraph 30.13) in the consolidated financial statements.

In other words, on 31 December 20X0, the exchange difference on the parent's long-term loan is reclassified from profit or loss to other comprehensive income as set out in the following pro forma consolidation journal entry:

Dr	Other comprehensive income	CU476	
	Cr	Profit or loss—Exchange difference	CU476

To recognise the consolidation adjustment related to the exchange difference.

The principle in this example applies equally to branches that have a different functional currency to the rest of the parent entity.

Ex 22 The facts are the same as in Example 21 except that the loan is expected to be repaid five years after its inception and is not regarded as part of the parent entity's net investment in foreign operation.

Parent's separate financial statements, if prepared

Initial recognition

On 1 January 20X0, the foreign currency loan receivable is recorded as follows:

Dr	Loan to subsidiary (long-term receivable)	CU10,000	
	Cr	Cash	CU10,000

To recognise the foreign currency loan to subsidiary (FCU20,000 ÷ FCU2).

Subsequent measurement

On 31 December 20X0, the foreign currency loan receivable is translated as follows:

Dr	Profit or loss—Exchange difference	CU476	
	Cr	Loan to subsidiary (long-term receivable)	CU476

To translate the foreign currency loan to subsidiary (FCU20,000 ÷ FCU2.1 = CU9,524 – CU10,000).

Subsidiary's financial statements, if prepared

Initial recognition

On 1 January 20X0, the loan payable is recorded as follows:

Dr	Cash	FCU20,000	
	Cr	Loan from parent (long-term payable)	FCU20,000

To recognise the loan from its parent.

Consolidated financial statements (assuming presentation currency is CU)

In this example, the exchange difference of CU476 in the parent's separate financial statements remains recognised in profit or loss in the consolidated financial statements because the loan is not a part of the parent's net investment in the foreign subsidiary. Consequently, in the consolidated financial statements there are no consolidation entries related to the exchange difference on 31 December 20X0.

Note: this example applies equally to branches.

Example—Parent makes a CU-denominated loan to foreign subsidiary

Ex 23 The facts are the same as in Example 21. However, in this example, the loan is CU denominated. In other words, on 1 January 20X0, a parent entity (whose functional currency is CU) loaned CU10,000 to a foreign subsidiary (whose functional currency is FCU). The loan bears interest at a market rate payable annually at the end of each calendar year. The parent has informed the subsidiary that it does not expect to demand repayment for the foreseeable future and the subsidiary does not expect to repay the loan. The amortised cost of the loan at each reporting date is CU10,000. The parent entity regards its receivable from its foreign subsidiary as part of its net investment in that foreign operation.

The exchange rates are as follows:

- 1 January 20X0: CU1 = FCU2
- 31 December 20X0: CU1 = FCU2.1

Parent's separate financial statements, if prepared (see paragraphs 9.24–9.27)

Initial recognition

On 1 January 20X0, the loan receivable is recorded as follows:

Dr	Loan to subsidiary (long-term receivable)	CU10,000	
	Cr	Cash	CU10,000

To recognise the loan to subsidiary.

Subsidiary's individual financial statements, if prepared

Initial recognition

On 1 January 20X0, the loan payable is recorded as follows:

Dr	Cash	FCU20,000	
	Cr	Loan from parent (long-term payable)	FCU20,000

To recognise the borrowing (the loan) from the parent entity (CU10,000 × 2).

Year ended 31 December 20X0

On 31 December 20X0, the subsidiary translates the monetary item (a loan) at rate CU1 = FCU2.1.

The journal entries for the exchange difference are:

Dr	Profit or loss—Exchange difference	FCU1,000	
	Cr	Loan from parent (long-term payable)	FCU1,000

To recognise the exchange difference that arises on translating a monetary item at the end of reporting period.

Note: the exchange loss of FCU1,000 on the CU-denominated loan is recognised by the foreign subsidiary because it is exposed to foreign exchange risk.

Parent's consolidated financial statements (assuming group presentation currency is CU)

On consolidation, the inter-company loan is eliminated in full (see paragraph 9.15). However, because the long-term loan is a part of the parent's net investment in the subsidiary, the exchange loss of CU476 (calculation: FCU1,000 ÷ 2.1) is transferred to other comprehensive income. A corresponding exchange difference is included in other comprehensive income arising from translation of the net assets of overseas subsidiary (see paragraph 30.18).

On 31 December 20X0, the following pro forma consolidation journal entry is made:

Dr	Other comprehensive income	CU476	
	Cr	Profit or loss—Exchange difference	CU476

To recognise the consolidation adjustment related to the exchange difference (FCU1,000 ÷ 2.1).

Note: the principle in this example applies equally to foreign branches.

Example—Investor makes a CU-denominated loan to a foreign associate

Ex 24 The facts are the same as in Example 23 except that the foreign operation is a foreign associate, not a foreign subsidiary.

Investor's separate financial statements, if prepared

In accordance with paragraph 14.4, an entity adopts a policy of accounting for its investments in associates either at cost minus impairment, at fair value with changes in fair value recognised in profit or loss or the equity method.

For the entries related to the loan receivable, see the investor's separate financial statements in Example 21.

Associate's individual financial statements

The entries in the associate's individual financial statements are the same as in Example 23 for the subsidiary's individual financial statements.

Investor's main financial statements (these will be consolidated financial statements if the entity has subsidiaries)

In accordance with the investor's accounting policy, the foreign associate is accounted for using the cost model (Scenario 1), the fair value model (Scenario 2) or the equity method (Scenario 3) as set out in Table 1.

Table 1—Accounting for a foreign associate

	<i>Scenario 1</i>	<i>Scenario 2</i>	<i>Scenario 3</i>
Investor's main financial statements	Except for the recognition of the loan (similar to Example 23), there are no transactions to record relating to the exchange loss, because the investor's share of the profits is only recognised as dividends.	Except for the recognition of the loan (similar to Example 23), there are no further transactions to record relating to the exchange loss because the investor's share of the exchange loss is one component of the recognised change in fair value.	In addition to the recognition of the loan (similar to Example 23), the investor's share of the exchange difference will be recognised as income or an expense and presented in other comprehensive income. For example, if the investor owns 30% of the voting power of the associate, then CU143 (FCU1,000 ÷ 2.1 × 30%) of the exchange loss is recognised in other comprehensive income (outside profit or loss).

Note: the principle in this example applies equally to interests in jointly controlled entities because they are accounted for in the same way as interests in associates.

Change in functional currency

30.14 When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

Educational notes

An entity does not choose its functional currency. Rather, its functional currency is determined in accordance with paragraphs 30.2–30.5 based on facts and circumstances (paragraph 30.15 states that 'the underlying transactions, events and conditions that are relevant to the entity'). Therefore, a change in functional currency results from a change in an entity's circumstances. It follows that useful information is provided by accounting for the effect of a change in functional currency prospectively—a more faithful representation is achieved by measuring items in the 'old' functional currency before the change and in the 'new' functional currency after the change.

A change of functional currency is not a change in accounting policy (as described in Section 10 *Accounting Policies, Estimates and Errors*). Therefore, a change in functional currency is accounted for prospectively. Retrospective restatement would be necessary if the identification of an entity's functional currency was made in error.

30.15 As noted in paragraphs 30.2–30.5, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.

Example—Foreign subsidiary changes operations

Ex 25 In 20X1, a parent entity whose functional currency is CU, purchased an overseas SME subsidiary. For many years after acquisition, the subsidiary operated independently of its parent and during this time the functional currency of the subsidiary was determined to be FCU (the local currency in the subsidiary's jurisdiction). However, in 20X5, because of an increase in labour and material costs in the subsidiary's jurisdiction, the subsidiary stopped manufacturing its own products and began distributing the parent's products in its jurisdiction. The subsidiary's manufacturing facilities were sold to a third party. Management reassessed the subsidiary's functional currency and determined it to be CU.

The entity's circumstances changed when it changed from being the independent manufacturer of its products to distributing locally the products manufactured by its parent. Consequently, provided that the functional currency has been appropriately determined in accordance with paragraphs 30.2–30.5, this would constitute a change in the subsidiary's functional currency from FCU to CU. In accordance with paragraph 30.16, the effect of the change of functional currency is accounted for prospectively from the date of the change.

30.16 The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost.

Examples—Effect of changes in functional currency

Ex 26 Until 31 December 20X2 (its financial year-end) an SME's functional currency was CU. It presented its financial statements in CU.

At the start of 20X3, because of a change in circumstances, the functional currency of the SME changed to FCU. The date of the change in the functional currency was determined to be 1 January 20X3.

Situation 1: the SME chooses to present its 20X3 financial statements in FCU (change of both the functional currency and the presentation currency)

On 1 January 20X3 the SME translates all items in its statement of financial position at 31 December 20X2 from the old functional currency (CU) into the new functional currency (FCU) using the exchange rate on 1 January 20X3. The resulting translated amounts for non-monetary items are treated at their historical cost.

All transactions that take place in 20X3 in a currency other than FCU are foreign currency transactions and are translated into the functional currency FCU on initial recognition. Consequently, the transactions in 20X3 and the balances at the end of 20X3 will all be measured in FCU and are used to prepare the financial statements for the year ended 31 December 20X3. The 20X2 comparatives in the financial statements for the year ended 31 December 20X3 must be translated from CU (the functional currency of the entity in 20X2) into FCU. Note that the change in presentation currency is accounted for as a change in accounting policy (the new policy is applied retrospectively or, in other words, as if the new presentation currency had always been the presentation currency).

Situation 2: the SME chooses to continue to present its financial statements in CU (the functional currency changes, but the presentation currency remains unchanged)

On 1 January 20X3 the SME translates all items in its statement of financial position at 31 December 20X2 into the new functional currency using the exchange rate on 1 January 20X3. The resulting translated amounts for non-monetary items are treated at their historical cost.

All transactions that take place in 20X3 in a currency other than FCU are foreign currency transactions and are translated into the functional currency (FCU) on initial recognition. Consequently, the transactions in 20X3 and the balances at the end of 20X3 will all be measured in FCU and so must be translated into the presentation currency (CU) in accordance with paragraph 30.18 in order to present financial statements in CU. The comparative information can be taken from the financial statements for the year ended 31 December 20X2. They are already in CU and do not need to be adjusted.

Ex 27 The facts are the same as in Situation 1 of Example 26. On 1 January 20X0, the SME purchased an item of machinery for FCU100,000 when the exchange rate was CU1 = FCU2. The SME is depreciating the machine over ten years on a straight-line basis. On 1 January 20X3 the exchange rate is CU1 = FCU1.8.

On 1 January 20X0, the entity's functional currency is CU and so the machine is recorded on initial recognition at CU50,000 ($\text{FCU}100,000 \div 2$).

On 31 December 20X2 three years of depreciation will have been charged on the machine ($\text{CU}15,000 = \text{CU}50,000 \div 10 \times 3$). Consequently, the machine is recorded at CU35,000 ($\text{CU}50,000 - \text{CU}15,000$).

Because the functional currency has changed, the machine is translated into the new functional currency (FCU) on 1 January 20X3. Consequently, the carrying amount of the machine on 1 January 20X3 is recorded at FCU63,000 ($\text{CU}35,000 \times 1.8$) and this is treated as the historical cost of the machine at the date of the change in functional currency. Assuming that management assesses the machine's remaining useful life at seven years and its residual value at zero, then a depreciation expense of FCU9,000 ($\text{FCU}63,000 \div 7$) will be recognised each year. Consequently, on 31 December 20X3 the machine will have a carrying amount of FCU54,000 ($\text{FCU}63,000 - \text{FCU}9,000$).

Use of a presentation currency other than the functional currency

Translation to the presentation currency

30.17 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, the entity shall translate its items of income and expense and **financial position** into the presentation currency. For example, when a **group** contains individual entities with different functional currencies, the items of income and expense and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

Educational notes

An entity's presentation currency is the currency in which its financial statements are presented. Although an entity must always measure foreign currency transactions in the functional currency, it can choose to present its financial statements in any currency. Consequently, an entity's presentation currency need not be the same as its functional currency. Unless they have a specific reason for not doing so, many entities are likely to present their financial statements in their functional currency.

Although entities have a free choice when selecting their presentation currency, if a currency other than the functional currency is chosen, the reason for selecting the different currency must be disclosed (see paragraph 30.26). An entity might be required by some domestic regulation to present its financial statements in the local currency even if this is not its functional currency. Another reason may be that an entity's main investors, or providers of finance, are predominantly based overseas.

Translation into a presentation currency occurs most often in relation to group financial statements because the results and financial position of each group entity must be expressed in a common currency before they are incorporated into the consolidated financial statements (see paragraph 30.22).

- 30.18 An entity whose functional currency is not the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the following procedures:
- (a) assets and liabilities for each **statement of financial position** presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position;
 - (b) income and expenses for each **statement of comprehensive income** (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and
 - (c) all resulting exchange differences shall be recognised in other comprehensive income and reported as a component of equity. They shall not subsequently be reclassified to profit or loss.

Educational notes

Presenting financial statements in a different currency to the entity's functional currency does not change the measurement of the underlying items. It merely expresses the amounts for those items, which have been initially measured in the functional currency, in a different currency.

- 30.19 For practical reasons, an entity may use a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Educational notes

In other words, average exchange rates can be used, provided that the outcome of using those rates is not materially different from using actual exchange rates.

In examples 28–30, an average rate for the entire year has been used for simplicity. However, had exchange rates fluctuated significantly during the year this would not be appropriate. In such cases, average rates for a series of narrower periods might be appropriate. Example 30 illustrates the use of an average rate for a month.

Example—Use of a presentation currency other than the functional currency

Ex 28 Entity A is a stand-alone entity (it is not part of a group). Its functional currency is CU. However, Entity A is required by law to present its financial statements in LCA, which is the local currency of the country in which it operates. Entity A has a 31 December financial year-end.

The exchange rates at 31 December 20X1 and 31 December 20X2 are CU1 = LCA2 and CU1 = LCA2.3 respectively.

The weighted average rate for the year ended 31 December 20X2 is CU1 = LCA2.2.

In 20X2 Entity A paid a dividend of CU3,000 when the rate of exchange was CU1 = LCA2.25.

The share capital was issued when the exchange rate was CU1 = LCA1.8.

Entity A records all its transactions in its functional currency in accordance with Section 30. The statement of comprehensive income and an extract from the statement of changes in equity for the year ended 31 December 20X2 prepared in the functional currency are as follows:

Statement of comprehensive income for the year ended 31 December 20X2

	20X2 CU
Revenue	146,114
Cost of sales	(113,969)
Gross profit	32,145
Distribution costs	(150)
Administrative expenses	(9,000)
Other expenses	(1,000)
Finance costs	(3,000)
Profit before tax	18,995
Income tax expense	(4,495)
Profit for the year	14,500

Extract from the statement of changes in equity

Retained earnings at the beginning of year	18,000
Profit for the year	14,500
Dividends	(3,000)
Retained earnings at end of year	29,500

Notes

- The weighted average exchange rate for the year ended 31 December 20X1 is CU1 = LCA1.9.
- At 1 January 20X1, a cumulative gain of LCA2,800 has been recognised in the foreign exchange reserve, which is due to translation of the entity's financial statements into LCA at previous periods.
- Retained earnings at 1 January 20X1 were LCA22,000.

The statements of financial position at 31 December 20X2 and 20X1 are as follows:

	20X2 CU	20X1 CU
Property, plant and equipment	85,000	90,000
Inventory	8,000	3,000
Trade and other receivables	12,000	5,000
Cash	5,000	3,000
Total assets	110,000	101,000
Trade and other payables	5,500	3,000
Overdraft	5,000	10,000
Loan	50,000	50,000
Total liabilities	60,500	63,000
Share capital	20,000	20,000
Retained earnings	29,500	18,000
Total equity	49,500	38,000
Total liabilities and equity	110,000	101,000

Statement of financial position at 31 December 20X2 (and 20X1) translated into LCA:

	20X2 CU	Rate ^(a)	20X2 LCA	20X1 CU	Rate ^(a)	20X1 LCA
Property, plant and equipment	85,000	2.3	195,500	90,000	2	180,000
Inventory	8,000	2.3	18,400	3,000	2	6,000
Trade and other receivables	12,000	2.3	27,600	5,000	2	10,000
Cash	5,000	2.3	11,500	3,000	2	6,000
Total assets	110,000		253,000	101,000		202,000
Trade and other payables	5,500	2.3	12,650	3,000	2	6,000
Overdraft	5,000	2.3	11,500	10,000	2	20,000
Loan	50,000	2.3	115,000	50,000	2	100,000
Total liabilities	60,500		139,150	63,000		126,000
Share capital	20,000	1.8	36,000	20,000	1.8	36,000
Retained earnings ^(b)	29,500		62,350	18,000		37,200
Foreign exchange reserve ^(c)	—		15,500	—		2,800
Total equity	49,500		113,850	38,000		76,000

(a) All assets and liabilities are translated at the closing exchange rate, which is CU1 = LCA2 on 31 December 20X1 and CU1 = LCA2.3 on 31 December 20X2. Share capital is translated at the historical rate CU1 = LCA1.8. Paragraphs 30.17–30.23 provide no explicit guidance in translating share capital. In this and subsequent examples, share capital is translated using the historical rate. If the closing rate is used, a translation difference arises if and when consolidation procedures are performed (see paragraph 9.13). Such translation difference is accounted for under paragraph 30.18(c). Regardless of the translation rate, total equity in the presentation currency would remain the same.

(b) Retained earnings at 31 December 20X2 and 31 December 20X1:

	20X2	20X1
	LCA	LCA
Opening retained earnings	37,200	22,000
Profit for the year ^(d)	31,900	15,200
Dividends paid ^(e)	(6,750)	—
Total	62,350	37,200

(c) In this example, the foreign exchange reserve is the exchange difference resulting from: (a) translating income and expense at the weighted average exchange rate and assets and liabilities at the closing rate; and (b) translating the opening net assets at a closing rate that differs from the previous closing rate. Put simply, this is also the figure that will balance the total assets against total liabilities and equity.

(d) Profit for 20X1 was translated at a weighted average rate CU1 = LCA1.9; CU8,000 × 1.9 = LCA15,200. Profit for 20X2 was translated at a weighted average rate CU1 = LCA2.2; CU14,500 × 2.2 = LCA31,900.

(e) Dividends paid were translated at the rate CU1 = LCA2.25.

Statement of comprehensive income for the year ended 31 December 20X2 translated into LCA:

	20X2 CU	Rate	20X2 LCA
Revenue	146,114	2.2	321,451
Cost of sales	(113,969)	2.2	(250,732)
Gross profit	32,145		70,719
Distribution costs	(150)	2.2	(330)
Administrative expenses	(9,000)	2.2	(19,800)
Other expenses	(1,000)	2.2	(2,200)
Finance costs	(3,000)	2.2	(6,600)
Profit before tax	18,995		41,789
Income tax expense	(4,495)	2.2	(9,889)
Profit for the year	14,500		31,900
Other comprehensive income:			
Exchange difference on translating from CU to LCA ^(a)			12,700
Total comprehensive income			44,600

(a) This is the net movement of foreign exchange reserve in the statement of financial position (CU15,500 – CU2,800).

Statement of changes in equity for the year ended 31 December 20X2 translated into LCA:

	Share capital	Retained earnings	Foreign exchange reserve	Total
Balance at 1 January 20X2	36,000	37,200	2,800	76,000
Dividends	–	(6,750)	–	(6,750)
Profit for 20X2	–	31,900	–	31,900
Exchange difference	–	–	12,700	12,700
Balance at 31 December 20X2	36,000	62,350	15,500	113,850

Example—Treatment of issue of additional share capital in the year

Ex 29 The facts are the same as in Example 28, except that on 1 December 20X2 Entity A issued CU10,000 more capital when the currency exchange rate was CU1 = LCA2.6. This increases cash by CU10,000 and share capital by CU10,000. Consequently, on 31 December 20X2 net assets increased by CU10,000 to CU59,500.

Statements of financial position at 31 December 20X2 (and 20X1) translated into LCA:

	20X2 CU	20X2 LCA	20X1 CU	20X1 LCA
Property, plant and equipment	85,000	195,500	90,000	180,000
Inventory	8,000	18,400	3,000	6,000
Trade and other receivables	12,000	27,600	5,000	10,000
Cash	15,000	34,500	3,000	6,000
Total assets	120,000	276,000	101,000	202,000
Trade and other payables	5,500	12,650	3,000	6,000
Overdraft	5,000	11,500	10,000	20,000
Loan	50,000	115,000	50,000	100,000
Total liabilities	60,500	139,150	63,000	126,000
Share capital	30,000	62,000	20,000	36,000
Retained earnings	29,500	62,350	18,000	37,200
Foreign exchange reserve	–	12,500	–	2,800
Total equity	59,500	136,850	38,000	76,000

As in Example 28, all assets and liabilities (and consequently net assets) are translated at the closing exchange rate, which is CU1 = LCA2 on 31 December 20X1 and CU1 = LCA2.3 on 31 December 20X2. The share capital issued before 20X1 is translated at the historic rate of CU1 = LCA1.8. The share capital issued on 1 December 20X2 is translated at the historic rate of CU1 = LCA2.6.

Calculations for retained earnings at 31 December 20X2 and profit for the year are the same as in Example 28.

In this example, the foreign exchange reserve is the exchange difference resulting from: (a) translating income and expense at the weighted average exchange rate and assets and liabilities at the closing rate; and (b) translating the opening net assets at a closing rate that differs from previous closing rate.

Statement of changes in equity for the year ended 31 December 20X2 translated into LCA:

	Share capital	Retained earnings	Foreign exchange reserve	Total
Balance at 1 January 20X2	36,000	37,200	2,800	76,000
Issue of share capital	26,000	—	—	26,000
Dividends	—	(6,750)	—	(6,750)
Profit for 20X2	—	31,900	—	31,900
Exchange difference	—	—	9,700	9,700
Balance at 31 December 20X2	62,000	62,350	12,500	136,850

Example—Translating revenue using monthly average rates

Ex 30 The facts are the same as in Example 29, except that the entity uses monthly average rates rather than an annual rate. Assume that average rates for each month and revenue for each month are as follows:

Month	Revenue	Average exchange rate
	CU	CU1 = LCAX
January	7,000	2.10
February	7,500	1.80
March	9,000	1.60
April	10,000	1.80
May	11,000	2.00
June	13,000	2.40
July	12,500	2.50
August	14,000	1.80
September	14,200	2.20
October	15,800	2.50
November	16,500	2.60
December	15,614	2.40
Total	146,114	

The amount shown in the LCA financial statements for revenue would be LCA321,364 (see table below). The same process should be applied to other income and expenses. The actual rate should be used for any large one-off transactions.

Month	Revenue	Average exchange rate	Revenue
	CU	CU1 = LCAX	LCA
January	7,000	2.10	14,700.00
February	7,500	1.80	13,500.00
March	9,000	1.60	14,400.00
April	10,000	1.80	18,000.00
May	11,000	2.00	22,000.00
June	13,000	2.40	31,200.00
July	12,500	2.50	31,250.00
August	14,000	1.80	25,200.00
September	14,200	2.20	31,240.00
October	15,800	2.50	39,500.00
November	16,500	2.60	42,900.00
December	15,614	2.40	37,473.60
Total	146,114		321,363.60

30.20 The exchange differences referred to in paragraph 30.18(c) result from:

- (a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate; and
- (b) translating the opening net assets at a closing rate that differs from the previous closing rate.

When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to the **non-controlling interest** are allocated to, and recognised as part of, non-controlling interest in the consolidated statement of financial position.

Educational notes

Examples 31 and 32 show how the exchange difference in paragraph 30.18(c) arises. The calculations may also be used as a way of checking the amount of exchange gains or losses recognised in other comprehensive income in the translated financial statements.

The exchange differences specified in paragraph 30.18(c) are not recognised in profit or loss because they are unrelated to the entity's trading performance. Consequently, in the statement of comprehensive income, the exchange differences (income or expenses) are presented as other comprehensive income (outside profit or loss).

Exchange differences may also include movement in equity, for example, as a result of payment of dividends in the year or of issuing additional share capital.

Examples—Reconciliation of exchange difference

Ex 31 The facts are the same as in Example 28.

Exchange differences arise when translating an entity's results and financial position into a presentation currency that is different from the functional currency. The differences arise because total assets and total liabilities were translated at the closing exchange rate (CU1 = LCA2.3), while profit for the year, dividends paid and the opening balance of share capital and retained earnings were translated at different exchange rates. Hence, it is possible to reconcile the CU12,700 exchange difference from translating the financial statements into LCA as follows:

Reconciliation:

share capital at exchange rate as of 31 December 20X2 (CU1 = LCA2.3)	46,000
share capital at exchange rate as of 31 December 20X1 (CU1 = LCA2)	(40,000)
Difference in share capital	6,000
retained earnings at the beginning of the year at exchange rate as of 31 December 20X2 (CU1 = LCA2.3)	41,400
retained earnings at the beginning of the year at average exchange rate as of 31 December 20X1 (CU1 = LCA2)	(36,000)
Difference in retained earnings	5,400
profit for the year at exchange rate as of 31 December 20X2 (CU1 = LCA2.3)	33,350
profit for the year at average exchange rate for 20X2 (CU1 = LCA2.2)	(31,900)
Difference in profit for the year	1,450
dividends paid at exchange rate as of 31 December 20X2 (CU1 = LCA2.3)	(6,900)
dividends paid at exchange rate as of date of payment (CU1 = LCA2.25)	6,750
Difference in dividends paid	(150)
Exchange difference from translation that arises in the year	12,700

Ex 32 The facts are the same as in Example 30.

The difference between the exchange loss of LCA12,700 in Example 28 and the exchange loss of CU9,700 in Example 29 arises from the share capital issue in the year. It increases net assets by CU10,000.

As in Example 31, the exchange difference from translating the financial statements into the foreign currency (LCA9,700) can be reconciled as follows:

Reconciliation:

CU30,000 share capital at exchange rate as of 31 December 20X2 (CU1 = LCA2.3)	69,000
CU20,000 share capital at exchange rate as of 31 December 20X1 (CU1 = LCA2)	(40,000)
CU10,000 share capital at exchange rate as of 1 December 20X2 (CU1 = LCA2.6)	(26,000)
Difference in share capital	3,000
Difference in retained earnings	5,400
Difference in profit for the year	1,450
Difference in dividends paid	(150)
Exchange difference from translation that arises in the year	9,700

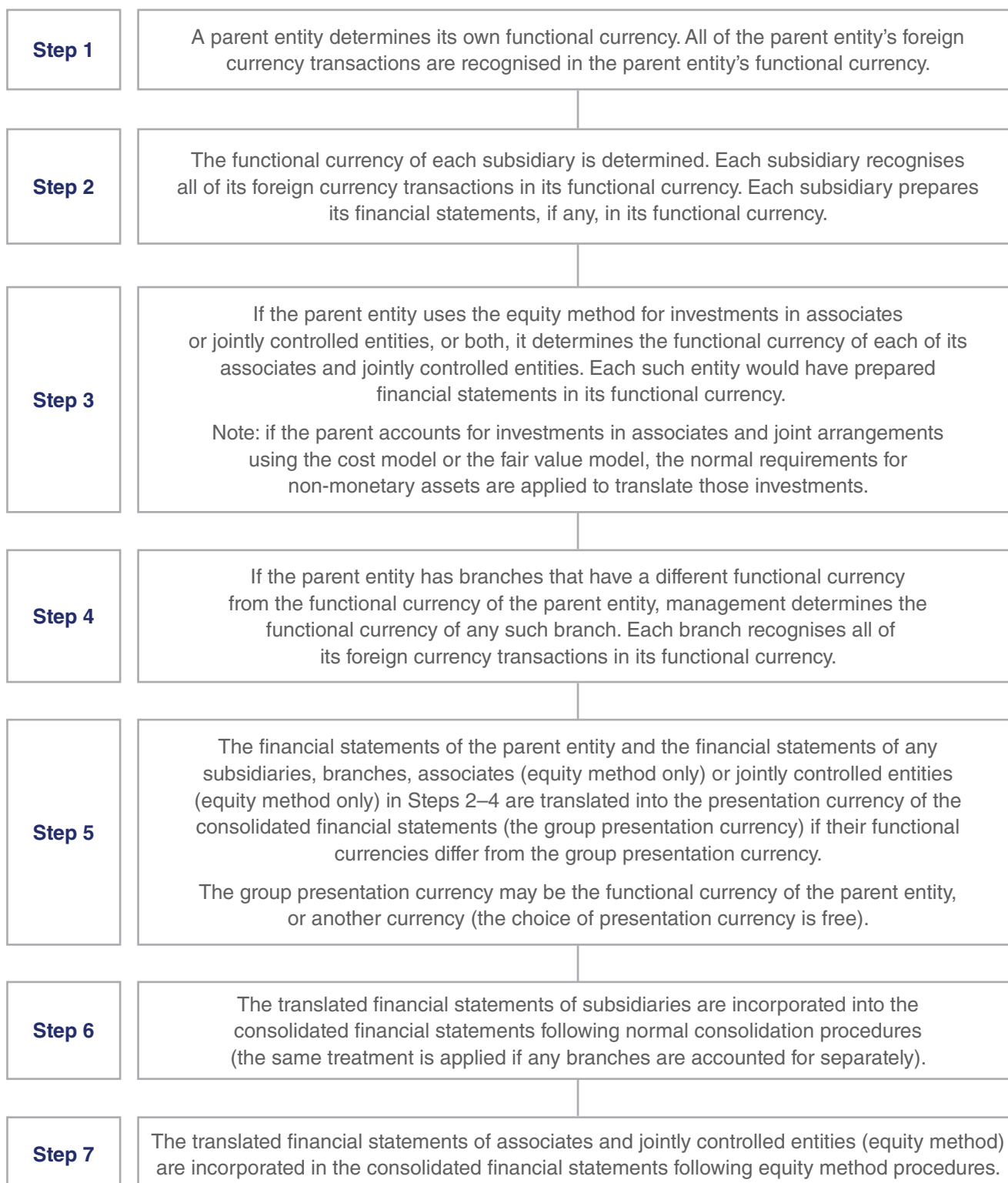
30.21 An entity whose functional currency is the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the procedures specified in Section 31 *Hyperinflation*.

Translation of a foreign operation into the investor's presentation currency

30.22 In incorporating the assets, liabilities, income and expenses of a foreign operation with those of the reporting entity, the entity shall follow normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see Section 9 *Consolidated and Separate Financial Statements*) and the translation procedures set out in paragraphs 30.17–30.21. 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. Accordingly, in the consolidated financial statements, a reporting entity continues to recognise such an exchange difference in profit or loss or, if it arises from the circumstances described in paragraph 30.13, the entity shall recognise it as other comprehensive income.

Educational notes

Figure 2—Summary of approach for a group of entities (a parent and its subsidiaries)



Exchange differences on intragroup monetary items

See Examples 21–23, which illustrate exchange differences on a monetary asset (or liability) between the parent and its foreign subsidiary, both in the parent’s consolidated and separate financial statements and the foreign subsidiary’s financial statements.

Foreign operation has a different year-end from the investor

In rare circumstances, the financial statements of a subsidiary used in the preparation of consolidated financial statements may be prepared to a different reporting date from that of the group (see paragraph 9.16). In such circumstances, the exchange rate at the subsidiary’s reporting date is used to translate the subsidiary’s financial statements. However, adjustments should be made if the exchange movement is significant between the subsidiary’s reporting date and the reporting date of the consolidated financial statements (paragraph 9.16 requires that adjustments should be made for any significant transactions or events that occur between these two dates).

30.23 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 shall be treated as assets and liabilities of the foreign operation. Thus, they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraph 30.18.

Educational notes

Fair value adjustments relate to the identifiable assets and liabilities of the acquired entity and are therefore translated into the presentation currency of the group at the closing rate when preparing consolidated financial statements.

In the Standard, goodwill is viewed as part of the parent’s net investment in the acquired entity. Consequently, goodwill is treated no differently from other assets of the acquired entity, in particular intangible assets, because a significant part of the goodwill is likely to be composed of intangible assets that do not qualify for separate recognition. When the acquired entity comprises a number of businesses with different functional currencies, the cash flows that support the continued recognition of goodwill are generated in those different functional currencies. Consequently, goodwill is treated as an asset of the foreign operation and is translated at the closing rate. Goodwill is therefore allocated to the level of each functional currency of the acquired foreign operation. This means that the level at which goodwill is allocated for foreign currency translation purposes may be different from the level at which the goodwill is tested for impairment. Entities follow the requirements in Section 27 to determine the level at which goodwill is tested for impairment.

When the exchange differences relate to a foreign operation that is consolidated but not wholly owned, accumulated exchange differences arising from translation and attributable to the non-controlling interest are allocated to, and recognised as part of, non-controlling interest in the consolidated statement of financial position (see paragraph 30.20).

Examples—Retranslation of goodwill

Ex 33 On 31 December 20X0, SME A (whose functional currency and presentation currency are both CU) acquires in a business combination a 100% interest in Entity B (whose functional currency is FCU) at a cost of FCU5,000 when the fair value of the Entity B's only asset, a machine, is FCU4,000. Entity B has no liabilities and no contingent liabilities. (For simplicity, amortisation of goodwill and depreciation of the machine were ignored.)

Exchange rates are:

- 31 December 20X0: CU1 = FCU2
- 31 December 20X1: CU = FCU2.1

SME A's consolidated statement of financial position at 31 December 20X1 includes:

- CU476 goodwill (calculation: FCU1,000 ÷ 2.1 closing exchange rate);
- CU1,905 property, plant and equipment (calculation: FCU4,000 ÷ 2.1 closing exchange rate); and
- CU119 translation adjustments in equity.

The consolidated statement of comprehensive income includes a foreign exchange loss of CU119 presented as other comprehensive income for the translation difference arising from the translation of the subsidiary's financial statements into the group's presentation currency.

The foreign exchange loss is calculated as (FCU1,000 goodwill + FCU4,000 machine) ÷ 2 opening exchange rate = CU2,500 group carrying amount of the subsidiary's assets at 31 December 20X0. CU2,500 at 31 December 20X0 – CU2,381 group carrying amount of the subsidiary's assets at 31 December 20X1 ((FCU1,000 goodwill + FCU4,000 machine) ÷ 2.1 closing exchange rate) = CU119.05 exchange difference.

Ex 34 The facts are the same as in Example 33. However, in this example, goodwill is amortised and the machine is depreciated using the straight-line method to a nil residual value over 10 years.

The average exchange rate for the year ended 31 December 20X1 is CU1 = FCU2.05.

SME A's consolidated statement of financial position at 31 December 20X1 includes:

- CU429 goodwill (calculation: (FCU1,000 gross – CU100 amortisation) ÷ 2.1 closing exchange rate);
- CU1,714 property, plant and equipment (calculation: (FCU4,000 gross – CU400 depreciation) ÷ 2.1 closing exchange rate); and
- CU113^(a) translation adjustments in equity.

The group's consolidated statement of comprehensive income includes:

- an expense of CU49 presented in profit or loss for the amortisation of goodwill (calculation: $\text{FCU}1,000 \div 10 \text{ years} = \text{FCU}100$ amortisation expense. $\text{FCU}100 \text{ amortisation} \div 2.05 = \text{CU}48.78$).
- an expense of CU195 presented in profit or loss for the depreciation of equipment (calculation: $\text{FCU}4,000 \div 10 \text{ years} = \text{FCU}400$ depreciation expense. $\text{FCU}400 \text{ depreciation} \div 2.05 = \text{CU}195.12$).
- an expense of CU113^(a) presented as other comprehensive income for the translation difference arising from the translation of the subsidiary's financial statements into the group's presentation currency.

(a) $\text{CU}22.65^{(b)} + \text{CU}90.59^{(c)} = \text{CU}113.24$ translation adjustment in equity.

(b) Calculation: translation loss for goodwill: $\text{FCU}1,000 \div 2.0$ opening exchange rate = CU500 goodwill recognised in the accounting for the business combination – CU48.78 amortisation expense – CU428.57 goodwill remaining at 31 December 20X1 ($\text{FCU}1,000 \times 9/10$ years = FCU900. $\text{FCU}900$ remaining balance $\div 2.1$ closing exchange rate = CU428.57) = CU22.65.

(c) Calculation: translation loss for the subsidiary's other net assets (machine): $\text{FCU}4,000 \div 2.0$ opening exchange rate = CU2,000 net assets recognised in the accounting for the business combination – CU195.12 depreciation expense – CU1,714.29 group carrying amount remaining at 31 December 20X1 ($\text{FCU}4,000 \times 9/10$ years = FCU3,600. $\text{FCU}3,600$ remaining balance $\div 2.1$ closing exchange rate = CU1,714.29) = CU90.59.

Disclosures

30.24 In paragraphs 30.26 and 30.27, references to 'functional currency' apply, in the case of a group, to the functional currency of the **parent**.

30.25 An entity shall disclose the following:

- (a) the amount of exchange differences recognised in profit or loss during the period, except for those arising on financial instruments measured at fair value through profit or loss in accordance with Section 11 *Financial Instruments*; and
- (b) the amount of exchange differences arising during the period and classified in a separate component of equity at the end of the period.

Examples—Disclosure required by paragraph 30.25(a)

Ex 35 The facts are the same as in Example 20. In addition, assume that the average exchange rate in 20X0 (for the seven months ended 31 December), is CU1 = FCU1.08 and in 20X1 is CU1 = FCU1.12.

The SME may present the following disclosure to comply with paragraph 30.25(a):²

[Extract from] Notes

Note 7 Investment property		
The movement of the entity's investment property is as follows:		
	20X1	20X0
	CU	CU
Opening balance	495,238	–
Additions	–	454,545
Changes in fair value	(45,238)	40,693
	<u>450,000</u>	<u>495,238</u>
Included in changes in fair value was a foreign exchange loss of CU63,095 (20X0: foreign exchange gain of CU22,174).		

This translation difference can be calculated as follows. It assumes that the changes in fair value are evenly distributed throughout the relevant period. It also assumes that the exchange rate does not fluctuate significantly. As such, the average rate for the period is used to translate the changes in fair value. Depending on the relevant facts and circumstances an entity has to decide whether the use of average rate is appropriate.

² Paragraph 16.10 of Section 16 *Investment Property* covers disclosure requirements for investment properties. The reconciliation described in paragraph 16.10(e) need not be presented for prior periods. In this example, the entity opts to present similar reconciliations in the prior period.

		20X1	20X0
Opening balance of investment property, at FCU	<i>A</i>	520,000	500,000
Closing balance of investment property, at FCU	<i>B</i>	540,000	520,000
Fair value gain, at FCU	$C = B - A$	20,000	20,000
Average exchange rate, CU to FCU	<i>D</i>	1.12	1.08
Net change in the value of investment property arising from fluctuation in fair value, translated at CU	$E = C \div D$	17,857	18,519
Net change in the value of investment property at CU (as reported in the table above)	<i>F</i>	(45,238)	40,693
Net change in the value of investment property arising from translation	$G = F - E$	(63,095)	22,174

As illustrated in this calculation, the net change in the value of investment property is composed of two factors—the change arising from fluctuation of fair values and from foreign currency translation. Since the fluctuation in fair values is in FCU and the entity reports in a different currency (CU), the entity is also exposed to foreign currency fluctuation.

The translation difference can be separately calculated as follows:

		20X1	20X0
Opening balance of investment property, at FCU	<i>A</i>	520,000	500,000
Opening exchange rate, CU to FCU	<i>B</i>	1.05	1.10
Closing exchange rate, CU to FCU	<i>C</i>	1.20	1.05
Translation difference on opening balance, at CU	$D = (A \div C) - (A \div B)$	(61,905)	21,645
Fair value gain, at FCU	<i>E</i>	20,000	20,000
Average exchange rate, CU to FCU	<i>F</i>	1.12	1.08
Closing exchange rate, CU to FCU	<i>G</i>	1.20	1.05
Translation difference on fair value gain, at CU	$H = (E \div G) - (E \div F)$	(1,190)	529
Translation difference	$I = D + H$	(63,095)	22,174

Alternatively, an SME may opt to recognise the translation difference as a separate item in profit or loss:

[Extract from] Notes

Note 7 Investment property		
The movement of the entity's investment property is as follows:		
	20X1	20X0
	CU	CU
Opening balance	495,238	–
Additions	–	454,545
Changes in fair value	17,857	18,519
Translation difference: gain (loss)	<u>(63,095)</u>	<u>22,174</u>
	<u>450,000</u>	<u>495,238</u>

An SME could present the disclosures for the amount of exchange differences recognised in profit or loss in the period as follows:

XYZ Group

[Extract from] Notes

Note 8 Profit before tax		
The following items have been recognised as expenses (income) in determining profit before tax:		
	20X2	20X1
	CU	CU
Cost of inventories recognised as expense	X	X
Research and development cost (included in other expenses)	X	X
Foreign exchange losses (gains) on trade receivables and payables (included in other expenses)	1,000	(2,000)

Example—Disclosure required by paragraph 30.25(b)

Ex 36 An SME could present in its consolidated financial statements the disclosures for the exchange differences arising in the period classified in a separate component of equity at the end of the period as follows:

Extract from accounting policies

Exchange differences arising from the translation of the financial statements of foreign operations are recognised in other comprehensive income and classified in a separate component of equity, 'foreign currency translation reserve', in the statement of financial position. Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation are also recognised in other comprehensive income and are also classified in the 'foreign currency translation reserve'. The amounts recognised in this reserve are never transferred to the profit or loss, even on disposal of the foreign operation.

XYZ Group

Extract from statement of changes in equity

	Share capital	Retained earnings	Foreign currency translation reserve	Total
	CU	CU	CU	CU
20X2				
Balance at the beginning of the year	X	X	225	X
Profit or loss		X		X
Other comprehensive income: exchange differences arising on translating the results and financial position of foreign operations			(75)	(75)
Balance at the end of the year	X	X	150	X
20X1				
Balance at the beginning of the year	X	X	105	X
Profit or loss		X		X
Other comprehensive income: exchange differences arising on translating the results and financial position of foreign operations			120	120
Balance at the end of the year	X	X	225	X

30.26 An entity shall disclose the currency in which the financial statements are presented. When the presentation currency is different from the functional currency, an entity shall state that fact and shall disclose the functional currency and the reason for using a different presentation currency.

Educational notes

Section 30 does not explicitly require an entity to present its accounting policy for foreign currency transactions and translations. However, if an entity has significant foreign activities it will usually disclose its accounting policy for foreign activities (see paragraphs 8.4 and 8.5). Examples 37 and 38 show one way in which a group of entities may set out its accounting policy for foreign activities in the consolidated financial statements.

Examples—Disclosure required by paragraph 30.26

Ex 37 An entity could present the disclosures for the currency in which its financial statements are presented as follows:

XYZ Group

[Extract from] Notes

Note 2 Accounting policies [extract]

Foreign currency translation

In preparing the financial statements of each individual entity within the group, transactions in foreign currencies are recognised in the individual entity's functional currency at the exchange rates at the transaction dates. At the year-end, monetary items denominated in foreign currencies are translated at the year-end exchange rate. Non-monetary items carried at fair value denominated in foreign currencies are translated at the exchange rate at the date when the fair value is determined. Non-monetary items measured in terms of historical cost in a foreign currency are translated at the date of the transaction.

In order to prepare the consolidated financial statements, all group entities translate their items of income and expense and financial position into currency units (CU), which is the functional currency of the parent company XYZ Co and the presentation currency for the consolidated financial statements.

continued ...

In the consolidated financial statements, exchange differences are recognised in consolidated profit or loss in the period in which they arise, except for the following recognised in other comprehensive income:

- exchange differences arising on monetary items considered part of the parent entity's net investment in a foreign operation. Such exchange differences will remain as part of equity even on disposal of the foreign operation.
- for non-monetary items, when a gain or loss is recognised in other comprehensive income, any exchange component of that gain or loss is also recognised in other comprehensive income.

Ex 38 An entity could present the reason for using a different presentation currency as follows:

ABC Entity

[Extract from] Notes

Note 2 Accounting policies [extract]

Foreign currency translation [extract]

In accordance with local laws, ABC entity (functional currency FCU) presents its financial statements in CU, the local currency of Z land, its country of incorporation.

30.27 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, the entity shall disclose that fact and the reason for the change in functional currency.

Notes

Paragraph 30.15 states that 'once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions'

Example—Disclosure required by paragraph 30.27

Ex 39 An SME could present the disclosures for the change in the functional currency as follows:

ABC Group

[Extract from] Notes

Note 2 Accounting policies [extract]

<i>Foreign currency translation [extract]</i>
--

During the year the functional currency of Subsidiary A changed from CU to FCU as a result of a decision to sell Subsidiary A's manufacturing activities and use Subsidiary A as an agent to sell Subsidiary B's products.
--

- 30.28 When an entity estimates a spot exchange rate because a currency is not exchangeable into another currency (see paragraph 30.5A), the entity shall disclose:
- (a) the currency and a description of the restrictions that result in that currency not being exchangeable into the other currency;
 - (b) a description of affected transactions;
 - (c) the carrying amount of affected assets and liabilities;
 - (d) the spot exchange rates used and whether those rates are:
 - (i) observable exchange rates without adjustment (see paragraphs 30A.13–30A.17); or
 - (ii) spot exchange rates estimated using another estimation technique (see paragraph 30A.18); and
 - (e) information about the estimation process, including qualitative and quantitative information about the inputs and assumptions used.

- 30.29 When a foreign operation's functional currency is not exchangeable into an entity's presentation currency or the presentation currency is not exchangeable into a foreign operation's functional currency, an entity shall disclose:
- (a) the name of the foreign operation;
 - (b) whether the foreign operation is a subsidiary, jointly controlled entity, associate or branch;
 - (c) the foreign operation's principal place of business;
 - (d) summarised financial information about the foreign operation; and
 - (e) the nature and terms of any contractual arrangements that could require the entity to provide financial support to the foreign operation, including events or circumstances that could expose the entity to a loss.

Example—Disclosures required by paragraphs 30.28–30.29

Ex 40 When it has estimated a spot exchange rate because a currency is not exchangeable into another currency, an SME could present the related disclosures as follows:

ABC Group

[Extract from] Notes

Foreign currency translation [extract]

The parent company has loans payable in currency LC, the currency of Jurisdiction L (see note xx). At the reporting date, because of restrictions on the exchange rate mechanisms in Jurisdiction L, the currency is not exchangeable into the company's presentation currency (PC).

The company estimated a spot exchange rate by using the exchange rate that became available on 18 January 20X1, shortly after the reporting date. Because this rate became available a short time after the reporting date, and Jurisdiction L has not been assessed as having a hyperinflationary economy, management considers that the rate reflects the prevailing economic conditions in Jurisdiction L at the reporting date and could therefore be used without adjustment.

The carrying amount of the loan payable at the reporting date was LC2,000,000. This carrying amount has been translated at the estimated rate of CU1:LC1.2 and is included in the statement of financial position at a value of CU1,666,667.

Subsidiary A is also located in Jurisdiction L so, at the reporting date, its functional currency was not exchangeable into PC. During the reporting period, Subsidiary A reported revenue of LC1,250,000 and profit of LC320,000, and at the reporting date it had net assets of LC 3,860,000. The company has no contractual obligations that could require it to provide support to Subsidiary A.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs Accounting Standard* to transactions and events often requires judgement, including making estimates. Information about significant judgements made by an entity's management and key sources of estimation uncertainty are useful when assessing an entity's financial position, performance and cash flows. Consequently, in accordance with paragraph 8.6, an entity discloses the judgements management has made when applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Furthermore, in accordance with paragraph 8.7, an entity discloses information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

Other sections of the *IFRS for SMEs Accounting Standard* require disclosure of information about particular judgements and estimation uncertainties.

Functional currency

An entity's functional currency is determined (not chosen). Paragraphs 30.3–30.5 provide factors, often referred to as indicators, that an entity is required to consider when identifying its functional currency. In some cases, the indicators will clearly identify a particular currency as the functional currency. In other cases they will not. When the factors provide a mixed result and the functional currency is therefore not obvious, management must use its judgement, based on the entity's individual facts and circumstances, to determine the entity's functional currency in order to result in a fair presentation (one that faithfully represents the economic effects of transactions, other events and conditions).

For example, when an entity has significant transactions in several currencies, or there is significant international influence on its sale prices or costs, the indicators provided in Section 30 are likely to provide a mixed result. Consequently, judgement will usually need to be applied to determine the appropriate functional currency.

Use of average rates

For practical reasons, paragraphs 30.8 and 30.19 permit an entity to use an average rate for a period to approximate the actual rates at the dates of the relevant transactions. Management will need to apply judgement based on an entity's specific facts and circumstances (such as the volatility of exchange rates or whether transactions arise evenly over the period) to determine whether it is appropriate to derive an average rate for the entire year, or whether an entity should use an average rate per month, or per week (for all or part of the year).

Net investment in a foreign operation

Judgement may need to be applied under paragraph 30.12 in assessing whether settlement of a monetary item with a foreign operation is neither planned nor likely to occur in the foreseeable future, and so is part of an entity's net investment in that foreign operation.

Translation of equity items to a presentation currency other than the functional currency

Section 30 provides no explicit guidance on translating equity items (share capital and other reserves) to a presentation currency that is different from an entity's functional currency. Retained earnings, accumulated from an entity's income and expenses, 'shall be translated at exchange rates at the dates of the transactions' (see paragraph 30.18(b)). An entity must use judgement to determine the exchange rate to be used when translating other equity items. Regardless of the exchange rates used, all resulting exchange differences on translation to a presentation currency 'shall be recognised in other comprehensive income and reported as a component of equity' and not subsequently reclassified to profit or loss (see paragraph 30.18(c)).

Lack of exchangeability

An entity might need to use judgement in determining whether a currency is exchangeable, in accordance with the new paragraph 30.5A and accompanying material which provides entities with information about how to make this judgement.

TRANSITION REQUIREMENTS

The third edition of the *IFRS for SMEs Accounting Standard* (the Standard) is effective for annual reporting periods beginning on or after 1 January 2027. Early application is permitted. Changes made to Section 30 from the second edition of the Standard are summarised on page 7.

Lack of exchangeability

- A45 An entity shall not retrospectively apply paragraph 30.5A. Instead, if the entity:
- (a) reports foreign currency transactions in its **functional currency** and concludes at the date of initial application that the two currencies are not exchangeable, the entity shall at the date of initial application:
 - (i) translate affected foreign currency **monetary items** and non-monetary items measured at fair value in a foreign currency using the estimated spot exchange rate at that date; and
 - (ii) recognise any effect of initially applying the amendments as an adjustment to the opening balance of retained earnings; or
 - (b) uses a **presentation** currency other than its functional currency or translates the results and financial position of a foreign operation and concludes at the date of initial application that the functional currency and presentation currency are not exchangeable, the entity shall at the date of initial application:
 - (i) translate affected assets and liabilities using the estimated spot exchange rate at that date;
 - (ii) translate affected equity items using the estimated spot exchange rate at that date if the entity's functional currency is hyperinflationary; and
 - (iii) recognise any effect of initially applying paragraph 30.5A as an adjustment to the cumulative amount of translation differences, accumulated in a separate component of equity.
- A46 An entity is not required to apply the disclosure requirements in paragraph 30.28 to comparative information provided for periods before the date of initial application.

Foreign currency transactions and advance consideration

- A47 An entity is permitted to prospectively apply paragraph 30.8A to all assets, **expenses** and **income** within the scope of paragraph 30.8A that were initially recognised on or after either:
- (a) the date of initial application; or
 - (b) the beginning of any comparative period presented.
- A48 An entity that applies paragraph A47 shall apply paragraph 30.8A on initial application to assets, expenses and income initially recognised on or after the date in paragraph A47(a) or paragraph A47(b) for which the entity has recognised non-monetary assets or non-monetary liabilities arising from advance consideration before that date.

Educational notes

The effect of these transition requirements is that the amendments relating to lack of exchangeability are applied from the date of initial application and there could be an amount for an entity to recognise in retained earnings or other components of equity at that date. Entities will benefit from the relief from providing comparative disclosures; in any event these would not have been meaningful since there is no option or requirement to restate comparatives.

In respect of advance consideration, entities are permitted to choose between full retrospective application (the default position for a change in accounting policy) and prospective application from the date of initial application or an earlier reporting date. Once the date of prospective application has been chosen, entities will apply the new policy to all relevant advance consideration assets and liabilities arising after that chosen date.

COMPARISON WITH FULL IFRS ACCOUNTING STANDARDS

The requirements in full IFRS Accounting Standards (see IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IFRIC 22 *Foreign Currency Transactions and Advance Consideration*) differ from those in the *IFRS for SMEs Accounting Standard* (see Section 30 *Foreign Currency Translation*) as at February 2025. The main differences are that:

- the *IFRS for SMEs Accounting Standard* is drafted in simple language with less application guidance than is provided in full IFRS Accounting Standards.
- the *IFRS for SMEs Accounting Standard* does not allow or require cumulative exchange differences that relate to a foreign operation that were previously recognised in other comprehensive income to be reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognised. IAS 21 requires such a treatment.

This table sets out the disclosure requirements in IAS 21 compared with the disclosure requirements in Section 30. 'X' means a disclosure requirement has no equivalent.

IAS 21 paragraph	Section 30 paragraph
52	25
53	26
54	27
A20	29
A19(a)–(e)	28
A19(f)	X
57	X
57A	X
57B	X
A18	X

TEST YOUR KNOWLEDGE

Test your knowledge of the requirements for including foreign currency transactions and foreign operations in the financial statements of an entity and translating financial statements into a presentation currency that is different from its functional currency applying the *IFRS for SMEs* Accounting Standard by answering the questions provided.

You should assume that all amounts mentioned are material.

Once you have completed the test, check your answers against those on page 85.

Mark the box next to the most correct statement.

Question 1

An entity's functional currency is:

- (a) The currency in which the financial statements are presented.
- (b) The currency of the primary economic environment in which the entity operates.
- (c) The currency in which sales prices for the entity's goods and services are denominated and settled.
- (d) Always the local currency of the country in which the entity is based.

Question 2

Which of the following factors is not a primary indicator of an entity's functional currency (it provides only supplementary evidence if the most important indicators are unclear):

- (a) The currency that mainly influences labour, material and other costs of providing goods or services.
- (b) The currency that mainly influences sales prices for goods and services.
- (c) The currency in which funds from financing activities are generated.
- (d) The currency of the country whose competitive forces and regulations mainly determine the sales prices of the goods and services.

Question 3

Which of the following additional indicators for determining the functional currency of a foreign operation does not support the proposition that the foreign operation's functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint arrangement):

- (a) Activities of the foreign operation are carried out as an extension of the reporting entity.
- (b) Transactions with the reporting entity are a high proportion of the foreign operation's activities.
- (c) Cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
- (d) Cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

Question 4

Section 30 states that an entity:

- (a) Must present its financial statements only in its functional currency.
- (b) May present its financial statements in any currency (or currencies).
- (c) Must present its financial statements in the local currency of the country in which the entity is based.
- (d) Must present its financial statements in its functional currency but may present additional financial statements in any currency (or currencies).

Question 5

SME A is the parent company of subsidiary B which has functional currency LC. When preparing its consolidated financial statements, SME A questions whether LC is exchangeable into its own functional and presentation currency, PC.

Which of the following factors would cause SME to conclude that LC is not exchangeable into PC?

- (a) Obtaining currency LC is subject to administrative delays of typically around one week.
- (b) SME A would not be able to obtain LC to settle its own liabilities, but can access it to receive dividends or recover its net investment.
- (c) SME A can obtain and sell any quantity of LC that it wishes.
- (d) The relevant authority in subsidiary B's jurisdiction is struggling with demand and has temporarily stopped making PC available through the exchange mechanism it administers, and SME A cannot access LC through any other mechanism or market in which an exchange transaction would create enforceable rights and obligations.

Question 6

On 1 December 20X1, an entity purchases raw materials costing FCU10,000 on credit. At the entity's year end, 31 December 20X1, the raw materials have not yet been used and are not impaired. The entity pays the supplier on 15 January 20X2. The entity has a functional currency of CU.

Exchange rates are as follows:

- 1 December 20X1: FCU1 = CU2
- 31 December 20X1: FCU1 = CU2.3
- 15 January 20X2: FCU1 = CU1.8

On 1 December 20X1 the entity makes the following journal entry:

Debit Inventory CU20,000

Credit Trade payables CU20,000

What are the correct journal entries on 31 December 20X1 for the transaction?

- (a) No adjustment on 31 December 20X1 so both the trade payable and the raw materials continue to be recorded at CU20,000.
- (b) Dr Inventory CU3,000
Cr Profit or loss (exchange difference) CU3,000
Dr Profit or loss (exchange difference) CU3,000
Cr Trade payable CU3,000

On 31 December both the trade payable and the raw materials are measured at CU23,000. There is no effect on profit or loss as the two exchange differences offset each other.

- (c) On 31 December 20X1:

No adjustment for inventory.

Dr Profit or loss (exchange difference) CU3,000
Cr Trade payable CU3,000

On 31 December the trade payable is measured at CU23,000 and the inventory is measured at CU20,000. The exchange loss on the trade payable is CU3,000.

- (d) Dr Inventory CU3,000
Cr Profit or loss (exchange difference) CU3,000

No adjustment for trade payable.

On 31 December the trade payable is measured at CU20,000 and the inventory is measured at CU23,000. The exchange gain on the inventory is CU3,000.

Question 7

The facts are the same as in Question 6. On 15 January 20X2 what journal entries are made when the trade payable is settled in cash at the spot exchange rate on that date?

- | | | | | | |
|--------------------------|-----|----|---|----------|----------|
| <input type="checkbox"/> | (a) | Dr | Trade payable | CU23,000 | |
| | | | Cr Profit or loss (exchange difference) | | CU5,000 |
| | | | Cr Cash | | CU18,000 |
| <input type="checkbox"/> | (b) | Dr | Trade payable | CU20,000 | |
| | | | Cr Profit or loss (exchange difference) | | CU2,000 |
| | | | Cr Cash | | CU18,000 |
| <input type="checkbox"/> | (c) | Dr | Trade payable | CU23,000 | |
| | | | Cr Cash | | CU23,000 |
| <input type="checkbox"/> | (d) | Dr | Trade payable | CU18,000 | |
| | | | Cr Cash | | CU18,000 |

Question 8

Which of the following monetary items may be part of a parent's net investment in a foreign subsidiary?

- (a) A ten-year loan from a parent to its foreign subsidiary for which the parent intends enforcing repayment when it is due.
- (b) A loan made from a parent to its foreign subsidiary which is payable on demand.
- (c) A trade receivable or trade payable between a parent and its subsidiary.
- (d) A loan made from a parent to its foreign subsidiary with no maturity date, where the parent has indicated that it does not expect to require repayment in the foreseeable future and the subsidiary does not expect to repay the loan.

Question 9

When an entity's functional currency changes, the entity is required:

- (a) To apply the translation procedures applicable to the new functional currency prospectively from the date of the change.
- (b) To apply the translation procedures applicable to the new functional currency retrospectively.
- (c) To disclose the fact that the entity's functional currency has changed and the reason for that change.
- (d) To perform both (a) and (c).

Question 10

Which of the following statements about how an entity is required to translate its results and financial position into a different presentation currency is not true?

Note: assume that the entity's functional currency is not the currency of a hyperinflationary economy.

- (a) Assets for each statement of financial position presented must be translated at the closing rate at the date of that statement of financial position.
- (b) Income and expenses for each statement of comprehensive income must be translated at exchange rates at the dates of the transactions.
- (c) Liabilities for each statement of financial position presented must be translated at the closing rate at the date of that statement of financial position.
- (d) All resulting exchange differences must be recognised in profit or loss.

Question 11

On 1 January 20X0, an entity purchased a tract of vacant land that is situated overseas for FCU90,000. The entity classified the land as an investment property. The fair value of the land at 31 December 20X0 is FCU100,000.

The entity's functional currency is CU.

Spot currency exchange rates:

- 1 January 20X0: FCU1 = CU2
- 31 December 20X0: FCU1 = CU2.1

The weighted average exchange rate in 20X0 is FCU1 = CU2.04.

What is the carrying amount of the investment property at 31 December 20X0 and what amounts would be presented in profit or loss for the year ended 31 December 20X0?

- (a) Carrying amount of investment property = CU210,000. Profit for the year includes CU30,000 increase in the fair value of investment property.
- (b) Carrying amount of investment property = CU210,000. Profit for the year includes CU20,400 increase in the fair value of investment property and CU9,600 foreign exchange gain.
- (c) Carrying amount of investment property = CU180,000. Profit for the year includes no amount in respect of the investment property.
- (d) Carrying amount of investment property = CU189,000. Profit for the year includes CU9,000 foreign exchange gain.
- (e) Either (a) or (b) provided the entity also complies with the disclosure requirement in paragraph 30.25(a).

Question 12

The facts are the same as in Question 11. However, in this question the fair value at 31 December 20X0 is unknown and the entity cannot, without undue cost or effort, determine the fair value of its investment property reliably on an ongoing basis.

What is the carrying amount of the investment property at 31 December 20X0 and what amounts would be presented in profit or loss for the year ended 31 December 20X0?

- (a) Carrying amount of investment property = CU210,000. Profit for the year includes CU30,000 increase in the fair value of investment property.
- (b) Carrying amount of investment property = CU210,000. Profit for the year includes CU20,400 increase in the fair value of investment property and CU9,600 foreign exchange gain.
- (c) Carrying amount of investment property = CU180,000. Profit for the year includes no amount in respect of the investment property.
- (d) Carrying amount of investment property = CU189,000. Profit for the year includes CU9,000 foreign exchange gain.

Answers

- Q1 (b)—See paragraph 30.2.
- Q2 (c)—See paragraphs 30.3 and 30.4.
- Q3 (d)—See paragraph 30.5.
- Q4 (b)—See paragraph 30.17.
- Q5 (d)—See paragraphs 30A.5–30A.8.
- Q6 (c)—See paragraphs 30.9 and 30.10.
- Q7 (a)—See paragraphs 30.9 and 30.10.
- Q8 (d)—See paragraph 30.12.
- Q9 (d)—See paragraphs 30.14 and 30.27.
- Q10 (d)—See paragraph 30.18.
- Q11 (e)—See paragraphs 30.9(c) and 30.25(a).
- Q12 (c)—See paragraph 30.9(b).

APPLY YOUR KNOWLEDGE

Apply your knowledge of the requirements for including foreign currency transactions and foreign operations in the financial statements of an entity, and translating financial statements into a presentation currency applying the *IFRS for SMEs* Accounting Standard, by completing the case studies provided.

Once you have completed each case study, check your answers against those on pages 87, 90, 96 and 102.

Case study 1

An SME that is a parent entity has two subsidiaries that are also SMEs, Subsidiary A and Subsidiary B. The parent is based in Country X (local currency CU). Subsidiary A is based in Country A (local currency LCA) and Subsidiary B is based in Country B (local currency LCB). The parent and Subsidiary B sell sports shoes. Subsidiary A sells sports equipment. Both subsidiaries are primarily financed by long-term loans in CU at market interest rates from the parent.

The parent prices its products in CU, most of its customers are based in Country X and revenues are usually collected in CU. The prices of the parent's products are most strongly determined by competition within the local market of Country X and are also affected by legal requirements and economic conditions in Country X. The salaries of employees are paid in CU. Most of the materials are sourced locally and, with other operating costs, are mostly paid in CU. The parent enters into a small number of purchase and sale transactions with entities overseas and these transactions are sometimes denominated and settled in a foreign currency.

Subsidiary A operates with significant autonomy from the parent. Subsidiary A manufactures its own products and sells them predominantly within Country A; the products are priced in LCA and customers settle in that currency too. Management of Subsidiary A determines the prices of the sports equipment based on local competition and regulations, without influence from the parent entity. Raw materials and labour are sourced locally. Some specialised machinery is purchased from abroad but the cost of such equipment is low in relation to other costs of producing the sports equipment. Subsidiary A occasionally imports and sells its parent's leading products, but this is only a small part of its business activity.

Subsidiary B's main business is to import shoes manufactured by its parent. Subsidiary B pays the parent in CU. The parent entity charges Subsidiary B the same price as the parent's own customers, minus a discount of 10%. The product is sold in Country B by Subsidiary B at prices denominated in LCB. All customers pay in LCB. Subsidiary B's prices are influenced by both local competition and regulations in Country B, and the cost of the product purchased from its parent. Subsidiary B needs the parent entity's approval for any significant price changes that do not reflect a fixed mark-up on changes in the purchase cost of the parent's products. All operating expenses, except for purchase of the parent's products, are incurred locally and paid in LCB. At the end of the month, any excess proceeds are transferred to the parent after paying the local expenses and the purchase price for the parent's products, as dividends.

Determine the functional currency of the parent entity and its two subsidiaries.

Answer to Case study 1

Parent entity

The factors in paragraph 30.3(a) support CU as being the functional currency of the parent. The parent's sales prices are determined by competition and regulation in Country X and CU is the currency in which the sales prices are denominated and settled. Prices are not significantly affected by international competition or by regulation and changes in exchange rates between CU and other currencies.

Paragraph 30.3(b) also indicates CU as being the parent's functional currency because the most significant costs of providing the products are denominated and settled in CU.

All of the factors in paragraph 30.3 indicate that CU is the functional currency of the parent. Consequently, without evidence to the contrary, CU should be determined as the functional currency of the parent entity. The parent entity need not consider the factors in paragraph 30.4.

Subsidiary A

The factors in paragraph 30.3(a) support LCA as being the functional currency of Subsidiary A. The sales prices for the subsidiary's sports equipment are determined by competition and regulation in Country A and LCA is the currency in which those sales prices are denominated and settled. Prices are not significantly affected by international competition or by regulation and changes in exchange rates between LCA and other currencies. Although Subsidiary A sometimes imports and sells its parent's products, this is only a small part of its business activity.

Paragraph 30.3(b) also indicates LCA as Subsidiary A's functional currency because the most significant costs of providing the products are denominated and settled in LCA.

All of the factors in paragraph 30.3 indicate that LCA is the functional currency of Subsidiary A. Consequently, without evidence to the contrary, LCA is the functional currency of Subsidiary A. Subsidiary A need not consider the factors in paragraphs 30.4 and 30.5.

Subsidiary B

Subsidiary B imports shoes manufactured by the parent and pays the parent in CU. The parent entity charges Subsidiary B the same price as the parent's own customers, minus a 10% discount. The product is sold in Country B by Subsidiary B at prices denominated in LCB. The prices are influenced both by local competition and regulations in Country B and the cost of the product purchased from the parent (and therefore by the exchange rate between CU and LCB). All operating expenses, except for purchase of the parent's products, are incurred locally and paid in LCB. Any excess proceeds are transferred to the parent after paying the local expenses, either as payment for the parent's products or as dividends.

Paragraph 30.3(a)(i) provides support for both CU and LCB as the functional currency. LCB is the currency in which Subsidiary B's sales prices are set, denominated and settled. However, those selling prices are influenced by movements in the exchange rate between CU and LCB because the selling price is affected by the cost of the parent's product, which is set in CU.

Paragraph 30.3(a)(ii) also provides support for both CU and LCB, because Subsidiary B's sales prices are affected both by competition and by regulation in Country X (because this affects the cost of the products that Subsidiary B purchases from the parent) and those in Country B.

Paragraph 30.3(b) provides support for both CU and LCB. The costs of the products from the parent are influenced by CU. All other costs of providing goods are in LCB.

Paragraph 30.3 therefore provides mixed support for both CU and LCB as the functional currency of Subsidiary B. Consequently, management should consider the secondary factors in paragraph 30.4 (secondary indicators for all entities) and in paragraph 30.5 (secondary indicators for foreign operations—because Subsidiary B is a foreign operation of the parent entity).

Funds from financing activities are generated primarily in CU (the loan from the parent entity). The entity keeps minimal cash reserves because any excess proceeds are transferred to the parent at the end of the month after paying the local expenses. Consequently, paragraph 30.4(b) provides support for CU as being the functional currency.

Paragraph 30.5 supports CU as being the functional currency as follows:

- the activities of the subsidiary are carried out as an extension of the parent because the subsidiary is selling the parent's product at a selling price approved by the parent entity;
- transactions with the parent are a high proportion of the subsidiary's activities because the parent entity is the subsidiary's only supplier; and
- cash flows from the activities of the subsidiary directly affect the cash flows of the reporting entity and are readily available for remittance to it because all excess cash is paid over to the parent at the end of the month.

Paragraph 30.5(d) does not indicate additional support for the parent's functional currency because cash flows from the activities of the subsidiary are expected to be sufficient to service the loan from the parent.

Paragraphs 30.3, 30.4 and 30.5 considered together support CU as being the functional currency. In the absence of evidence to the contrary, CU would be Subsidiary B's functional currency.

Case study 2

On 1 March 20X0, an SME whose functional currency is CU buys a retail outlet in another country (whose local currency is FCU) for FCU500,000 to sell products to customers in that country. The purchase price is financed by a FCU500,000 bank loan that bears interest at the fixed rate of 5% per year. The capital and interest on the loan is due on 1 March 20X1.

The outlet is depreciated using the straight line method over its remaining 20-year useful life to its zero residual value.

On 31 December 20X0, the SME performed an impairment test. It determined the recoverable amount of the outlet to be FCU550,000.

On 31 December 20X1, the SME performed another impairment test. It determined the recoverable amount of the outlet to be FCU300,000.

Spot currency exchange rates:

- 1 March 20X0: CU1 = FCU2;
- 31 December 20X0: CU1 = FCU2.4;
- 28 February 20X1: CU1 = FCU2.1; and
- 31 December 20X1: CU1 = FCU2.5.

The average rate from 1 March 20X0 to 31 December 20X0 is CU1 = FCU2.2, and the average rate from 1 January 20X1 to 28 February 20X1 is CU1 = FCU2.3.

Prepare the journal entries to account for the retail outlet and the loan in the SME's financial statements for the years ended 31 December 20X0 and 20X1.

Answer to Case study 2

Initial recognition

On 1 March 20X0, the outlet is recorded on initial recognition as follows:

Dr	Retail outlet—PPE	CU250,000	
	Cr	Liability—bank loan	CU250,000

To recognise the acquisition of the retail outlet (FCU500,000 ÷ 2).

Year ended 31 December 20X0

In 20X0, the SME records the loan as follows:

Dr	Profit or loss—Finance costs	CU9,470	
	Cr	Liability—Accrued interest on bank loan	CU9,470

To recognise accrued interest on the bank loan in 20X0 (5% × FCU500,000 × 10/12 months ÷ 2.2).

Dr	Liability—Accrued interest on bank loan	CU789	
	Cr	Profit or loss—Foreign exchange gain	CU789

To recognise foreign exchange gain on accrued interest on the bank loan in 20X0 (5% × FCU500,000 × 10/12 months ÷ 2.4) – CU9,470.

Dr	Liability—Bank loan	CU41,667	
	Cr	Profit or loss—Foreign exchange gain	CU41,667

To recognise foreign exchange gain on foreign bank loan in 20X0 (FCU500,000 ÷ 2.4) – CU250,000.

In 20X0, the SME records depreciation as follows:

Dr	Profit or loss—Depreciation charge	CU10,417	
	Cr	Accumulated depreciation and impairment—PPE outlet	CU10,417

To recognise depreciation of retail outlet in 20X0 (CU250,000 ÷ 20 years × 10/12 months)

On 31 December 20X0, cost minus depreciation is CU239,583 (CU250,000 – CU10,417). There is an indication of impairment because of the weakening of FCU against CU. The recoverable amount of the outlet is CU229,167 (FCU550,000 ÷ 2.4) which is less than the carrying amount. Consequently, even though there is no impairment in the foreign currency, there is an impairment in the SME's financial statements (in the functional currency). Notice that the recoverable amount on 31 December 20X0 as determined in the foreign currency (FCU550,000) is higher than its equivalent carrying amount in foreign currency (FCU500,000 – FCU20,833 accumulated depreciation measured in that foreign currency). Hence an impairment is recognised as follows:

Dr	Profit or loss—Impairment charge	CU10,416	
	Cr	Accumulated depreciation and impairment—PPE outlet	CU10,416

To recognise impairment of retail outlet in 20X0 (FCU550,000 ÷ 2.4) – (CU250,000 cost – CU10,417 accumulated depreciation).

On 31 December 20X0, the outlet is measured at its recoverable amount of CU229,167.

Year ended 31 December 20X1

Two months ended 28 February 20X1

Dr	Profit or loss—Finance costs	CU1,812	
	Cr	Liability—Accrued interest on bank loan	CU1,812

To recognise accrued interest on the bank loan in 20X0 (5% × FCU500,000 × 2/12 months ÷ 2.3).

28 February 20X1

Dr	Profit or loss—Foreign exchange loss	CU31,174	
	Liability—Accrued interest on bank loan	CU10,493	
	Liability—Bank loan	CU208,333	
	Cr	Cash	CU250,000

To recognise foreign exchange gain on settlement of the foreign bank loan (FCU500,000 × 105% ÷ 2.1).

In 20X1 the SME records the revised depreciation charge over 230 months (19 years and 2 months) as follows:

Dr	Profit or loss—Depreciation charge	CU11,957	
	Cr	Accumulated depreciation and impairment—PPE outlet	CU11,957

To recognise depreciation of retail outlet in 20X1 (CU229,167 ÷ 230 months × 12 months).

On 31 December 20X1, the recoverable amount is FCU300,000. This is CU120,000 ($\text{FCU}300,000 \div 2.5$). The carrying amount of the outlet without considering impairment on 31 December 20X1 is CU217,210 (CU229,167 – CU11,957). The recoverable amount is lower than the carrying amount of the outlet on 31 December 20X1 and so the SME records an impairment charge as follows:

Dr	Profit or loss—Impairment charge	CU97,210	
	Cr	Accumulated depreciation and impairment—PPE outlet	CU97,210

To recognise impairment of retail outlet in 20X1 (CU217,210 – CU120,000)

On 31 December 20X1, the outlet is measured at its recoverable amount of CU120,000.

Case study 3

SME A (a retailer) was founded on 1 January 20X0. SME A's functional currency is the CU. Because SME A's owners want to raise an overseas bank loan, they prepare SME A's financial statements in ACU (the currency of Country A, in which the overseas bank operates).

SME A's 20X0 and 20X1 draft financial statements prepared in its functional currency (CU) are as follows:

Statement of financial position at 31 December

	<i>20X1</i> <i>CU</i>	<i>20X0</i> <i>CU</i>
Property, plant and equipment	840	870
Inventory	150	250
Trade and other receivables	300	200
Cash	494	200
	<hr/> 1,784	<hr/> 1,520
Trade and other payables	160	100
Tax payable	99	126
Total liabilities	<hr/> 259	<hr/> 226
Share capital	1,000	1,000
Retained earnings	525	294
	<hr/> 1,525	<hr/> 1,294
Total liabilities and equity	<hr/> 1,784	<hr/> 1,520

Statement of comprehensive income for the year ended 31 December

	20X1 CU	20X0 CU
Revenue	700	800
Cost of sales	(200)	(250)
Gross profit	500	550
Distribution costs	(90)	(80)
Administrative expenses	(80)	(50)
Profit before tax	330	420
Income tax expense	(99)	(126)
Profit/Comprehensive income for the year	231	294

Statement of cash flows for the year ended 31 December

	20X1 CU	20X0 CU
<i>Cash flows from operating activities</i>		
Cash received from customers	600	600
Cash paid to suppliers and employees	(180)	(500)
Cash generated from operations	420	100
Income tax paid	(126)	–
Net cash from operating activities	294	100
<i>Cash flows from investing activity</i>		
Cash paid for a purchase of property, plant and equipment	–	(900)
<i>Cash flows from financing activity</i>		
Cash received from issuance of share capital	–	1,000
Net increase in cash and cash equivalents	294	200
Cash and cash equivalents at beginning of period	200	–
Cash and cash equivalents at end of period	494	200

Statement of changes in equity for the year ended 31 December

	<i>Share capital CU</i>	<i>Retained earnings CU</i>	<i>Total CU</i>
Balance at 1 January 20X0	1,000	–	1,000
Profit for 20X0	–	294	294
Balance at 31 December 20X0	1,000	294	1,294
Profit for 20X1	–	231	231
Balance at 31 December 20X1	1,000	525	1,525

The following spot currency exchange rates apply:

- 1 January 20X0: CU1 = ACU2
- 31 December 20X0: CU1 = ACU1.95
- 31 December 20X1: CU1 = ACU2.1
- When the income tax was paid in 20X1: CU1 = ACU2.05
- When equipment was bought and paid for in 20X0: CU1 = ACU1.9

The following weighted averages also apply:

- 20X0: CU1 = ACU2.11
- 20X1: CU1 = ACU1.79

Opening net assets at 1 January 20X0 = CU1,000.

For simplicity's sake, use the same average rate for translating the statement of comprehensive income and the statement of cash flows (excluding income tax paid and amount paid for a purchase of property, plant and equipment).

Translate SME A's 20X0 and 20X1 financial statements from the SME's functional currency (CU) to the SME's presentation currency (ACU).

Answer to Case study 3

Translation to the presentation currency—Statement of financial position

	20X1			20X0		
	CU	Rate	ACU	CU	Rate	ACU
Property, plant and equipment	840	2.1	1,764.0	870	1.95	1,696.5
Inventory	150	2.1	315.0	250	1.95	487.5
Trade and other receivables	300	2.1	630.0	200	1.95	390.0
Cash	494	2.1	1,037.4	200	1.95	390.0
	<u>1,784</u>		<u>3,746.4</u>	<u>1,520</u>		<u>2,964</u>
Trade and other payables	160	2.1	336.0	100	1.95	195.0
Tax payable	99	2.1	207.9	126	1.95	245.7
Total liabilities	<u>259</u>		<u>543.9</u>	<u>226</u>		<u>440.7</u>
Share capital	1,000	2	2,000.0	1,000	2	2,000.0
Foreign exchange reserve	–		168.7	–		(97.0)
Retained earnings	525		1,033.8	294	2.11	620.3
	<u>1,525</u>		<u>3,202.5</u>	<u>1,294</u>		<u>2,523.3</u>
Total liabilities and equity	<u>1,784</u>		<u>3,746.4</u>	<u>1,520</u>		<u>2,964</u>

Translation to the presentation currency—Statement of comprehensive income

	20X1			20X0		
	<i>CU</i>	<i>Rate</i>	<i>ACU</i>	<i>CU</i>	<i>Rate</i>	<i>ACU</i>
Revenue	700	1.79	1,253.0	800	2.11	1,688.0
Cost of sales	(200)	1.79	(358.0)	(250)	2.11	(527.5)
Gross profit	500		895.0	550		1,160.5
Distribution costs	(90)	1.79	(161.1)	(80)	2.11	(168.8)
Administrative expenses	(80)	1.79	(143.2)	(50)	2.11	(105.5)
Profit before tax	330		590.7	420		886.2
Income tax expense	(99)	1.79	(177.2)	(126)	2.11	(265.9)
Profit for the year	231		413.5	294		620.3
Other comprehensive income						
Exchange difference on currency translation	—		265.7	—		(97.0)
Total comprehensive income for the year	231		679.2	294		523.3

Calculation of foreign exchange differences

	20X1	20X0
Retranslation of opening net assets from opening rate to closing rate		
Opening net assets translated at opening rate	2,523.3	—
Opening net assets translated at closing rate	2,717.4	—
Difference	(194.1)	—
Retranslation of profit from average rate to closing rate		
Profit translated at average rate	413.5	620.3
Profit translated at closing rate	485.1	573.3
Difference	(71.6)	47.0
Total foreign exchange difference	(265.7)	97.0

Translation to the presentation currency—Statement of cash flows³

	20X1			20X0		
	CU	Rate	ACU	CU	Rate	ACU
<i>Cash flows from operating activities</i>						
Cash received from customers	600	1.79	1,074.0	600	2.11	1,266.0
Cash paid to suppliers and employees	(180)	1.79	(322.2)	(500)	2.11	(1,055.0)
Cash generated from operations	420		751.8	100		211.0
Income tax paid	(126)	2.05	(258.3)	–		–
Net cash from operating activities	294		493.5	100		211.0
<i>Cash flows from investing activity</i>						
Cash paid for a purchase of property, plant and equipment	–		–	(900)	1.9	(1,710.0)
<i>Cash flows from financing activity</i>						
Cash received from issuance of shares	–		–	1,000	2	2,000.0
Net increase in cash and cash equivalents	294		493.5	200		501.0
Cash and cash equivalents at beginning of period	200	1.95	390.0	–		–
Unrealised foreign exchange loss in cash and cash equivalents	n/a		153.9	n/a		(111.0)
Cash and cash equivalents at end of period	494	2.1	1,037.4	200	1.95	390.0

	Share capital ACU	Foreign exchange reserve ACU	Retained earnings ACU	Total ACU
Issuance of share capital	2,000.0	–	–	2,000
Comprehensive income for the year 20X0	–	(97.0)	620.3	523.3
Balance at 31 December 20X0	2,000.0	(97.0)	620.3	2,523.3
Comprehensive income for the year 20X1	–	265.7	413.5	679.2
Balance at 31 December 20X1	2,000.0	168.7	1,033.8	3,202.5

³ See paragraphs 7.11–7.13 for translating foreign currency cash flows.

Case study 4

On 1 January 20X1 SME D purchased 100% of the equity of subsidiary E for FCU2,000 when the fair value of subsidiary E's identifiable assets, liabilities and contingent liabilities was FCU1,800 and the exchange rate was CU1 = FCU2. Goodwill arising from that business combination is amortised on the straight-line method to a nil residual value over 10 years.

The D Group consists of a parent company (SME D) and its subsidiary (subsidiary E).

SME D's functional currency is the CU and subsidiary E's is the FCU.

On 2 February 20X1 when the exchange rate was CU1 = FCU2.1, SME D advanced a loan of FCU200 to subsidiary E. SME D informed subsidiary E that it did not expect to demand repayment for the foreseeable future, and subsidiary E does not expect to repay the loan. The amortised cost of the loan at each reporting date is FCU200 (for simplicity, in this example, interest on the loan is ignored).

The exchange rate at 31 December 20X1 was CU1 = FCU2.2 and the average rate for 20X1 was CU1 = FCU2.05.

SME D's statement of financial position and its statement of comprehensive income for the year ended 31 December 20X1, prepared in its functional currency (CU), are as follows:

SME D's statement of financial position at 31 December

	<i>31 December 20X0 CU</i>	<i>31 December 20X1 CU</i>
Property, plant and equipment	1,000	950
Investment in ABC Sub	–	1,000
Loan to subsidiary	–	91
Inventory	500	250
Trade and other receivables	200	100
Cash	2,000	1,325
	<hr/> 3,700 <hr/>	<hr/> 3,716 <hr/>
Trade and other payables	400	300
Bank loan	1,500	1,500
Total liabilities	<hr/> 1,900 <hr/>	<hr/> 1,800 <hr/>
Share capital	1,000	1,000
Retained earnings	800	916
	<hr/> 1,800 <hr/>	<hr/> 1,916 <hr/>
Total liabilities and equity	<hr/> 3,700 <hr/>	<hr/> 3,716 <hr/>

SME D's statement of comprehensive income for the year ended 31 December 20X1

	<i>CU</i>
Revenue	600
Cost of sales	(250)
Gross profit	<u>350</u>
Distribution costs	(100)
Administrative cost	(100)
Finance expense	(34)
Profit for the year	<u><u>116</u></u>

Subsidiary E's statement of financial position and its statement of comprehensive income for the year ended 31 December 20X1 prepared in its functional currency, FCU, are as follows:

Subsidiary E's statement of financial position at

	<i>1 January 20X1 FCU</i>	<i>31 December 20X1 FCU</i>
Property, plant and equipment	1,500	1,450
Inventory	600	400
Trade and other receivables	200	200
Cash	100	370
	<u>2,400</u>	<u>2,420</u>
Trade and other payables	600	350
Loan from parent	–	200
Total liabilities	<u>600</u>	<u>550</u>
Share capital	1,600	1,600
Retained earnings	200	270
	<u>1,800</u>	<u>1,870</u>
Total liabilities and equity	<u>2,400</u>	<u>2,420</u>

Subsidiary E's statement of comprehensive income for the year ended 31 December 20X1

	<i>FCU</i>
Revenue	500
Cost of sales	(200)
Gross profit	<u>300</u>
Distribution costs	(130)
Administrative cost	(100)
Profit for the year	<u>70</u>

Prepare SME D's consolidated statement of financial position at 31 December 20X1 and its consolidated statement of comprehensive income for the year ended 31 December 20X1.

For the purposes of this case study assume the following:

- The presentation currency for SME D's consolidated financial statements is the CU.
- Subsidiary E's financial statements have already been adjusted for any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of Subsidiary E by SME D in accordance with Section 9 *Consolidated and Separate Financial Statements*. In other words, Subsidiary E's financial statements are ready for consolidation and all that is required is translation into the presentation currency (CU), elimination of intragroup balances, and incorporation of Subsidiary E's financial statements in the consolidated financial statements on a line by line basis.
- The only intragroup transaction is the intragroup loan of FCU200.
- At 31 December 20X1, an exchange loss of CU4 on the intragroup loan was recognised in SME D's profit or loss and was presented in SME D's finance costs in its statement of comprehensive income.
- Translate Subsidiary E's share capital using the exchange rate on the date when SME D acquired Subsidiary E.

Answer to Case study 4

Consolidated statement of financial position at 31 December 20X1

Goodwill	82 ^(a)
Property, plant and equipment (= CU950 + CU659)	1,609
Inventory (= CU250 + CU182)	432
Trade and other receivables (= CU100 + CU91)	191
Cash (= CU1,325 + CU168)	1,493
	3,807
Trade and other payables (= CU300 + CU159)	459
Bank loan	1,500
Total liabilities	1,959
Share capital	1,000
Retained earnings	944 ^(b)
Foreign exchange reserve	(96) ^(c)
	1,848
Total liabilities and equity	3,807

Consolidated statement of comprehensive income for the year ended 31 December 20X1

Revenue (= CU600 + CU244)	844
Cost of sales (= CU250 + CU98)	(348)
Gross profit	496
Distribution costs (= CU100 + CU63)	(163)
Administrative cost (= CU100 + CU49 + CU10)	(159) ^(d)
Finance expense (= CU34 – CU4)	(30) ^(e)
Profit for the year	144
<i>Other comprehensive income</i>	
Exchange difference on translating foreign operation	(96)
Total comprehensive income for the year	48

(a) In accordance with paragraph 30.23, goodwill is treated as an asset of the subsidiary. Consequently, the carrying amount at 31 December 20X1 (FCU180) is translated at the closing rate (CU1 = FCU2.2).

(b) CU944 = CU800 (opening retained earnings of parent at 1 January 20X1) + CU144 (profit for the year in the consolidated statement of comprehensive income). Amortisation expense of goodwill (FCU20) was translated at the average rate (CU1 = FCU2.05).

(c) CU96 = CU84 (foreign exchange loss from translation of subsidiary's results and financial position into the presentation currency) + CU8 (foreign exchange loss on goodwill) + CU4 (foreign exchange difference on intragroup loan).

(d) CU159 = CU100 (administrative cost of the parent) + CU49 (administrative cost of subsidiary) + CU10 (amortisation of goodwill)

(e) CU30 = CU34 (finance expense of parent) – CU4 (foreign exchange difference on intragroup loan).

Translation of subsidiary to the presentation currency:

Subsidiary E's statement of financial position at 31 December 20X1 translated into CU

	<i>FCU</i>	<i>Rate</i>	<i>CU</i>
Property, plant and equipment	1,450	2.2	659
Inventory	400	2.2	182
Trade and other receivables	200	2.2	91
Cash	370	2.2	168
	2,420		1,100
Trade and other payables	350	2.2	159
Loan from parent	200	2.2	91
Total liabilities	550		250
Share capital	1,600	2	800
Retained earnings	270		134 ^(f)
Foreign exchange reserve	–		(84) ^(g)
	1,870		850
Total liabilities and equity	2,420		1,100

All assets and liabilities are translated at the closing exchange rate, which is CU1 = FCU2.2 on 31 December 20X1. The share capital is translated at a rate of CU1 = FCU2. It appears that Subsidiary E has the shares already issued before the acquisition by SME D. That exchange rate—when the shares were originally issued—was not used but, instead, the exchange rate at the date when SME D acquired Subsidiary E was used in translating the former's share capital because, from the perspective of SME D, this is the relevant rate in its financial statements.

- (f) Retained earnings—CU calculation: $CU134 = (FCU200 \text{ opening balance} \div 2 \text{ using } CU1 = FCU2 \text{ exchange rate at the date when SME D acquired Subsidiary E}) + (FCU70 \text{ profit for } 20X1 \div 2.05 \text{ using } CU1 = FCU2.05 \text{ average rate})$.

Subsidiary E's statement of comprehensive income for the year ended 31 December 20X1 translated into CU

Revenue	500	2.05	244
Cost of sales	(200)	2.05	(98)
Gross profit	300		146
Distribution costs	(130)	2.05	(63)
Administrative cost	(100)	2.05	(49)
Profit for the year	70		34

- (g) Calculation of foreign exchange loss (CU84):

Retranslation of opening net assets (assets at 1 January 20X1) from opening rate to closing rate		
Opening net assets translated at opening rate (FCU1,800 ÷ 2)	900	
Opening net assets translated at closing rate (FCU1,800 ÷ 2.2)	818	
Difference		82
Retranslation of profit from average rate to closing rate		
Profit translated at average rate (FCU70 ÷ 2.05)	34	
Profit translated at closing rate (FCU70 ÷ 2.2)	32	
Difference		2
Total foreign exchange loss		84



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