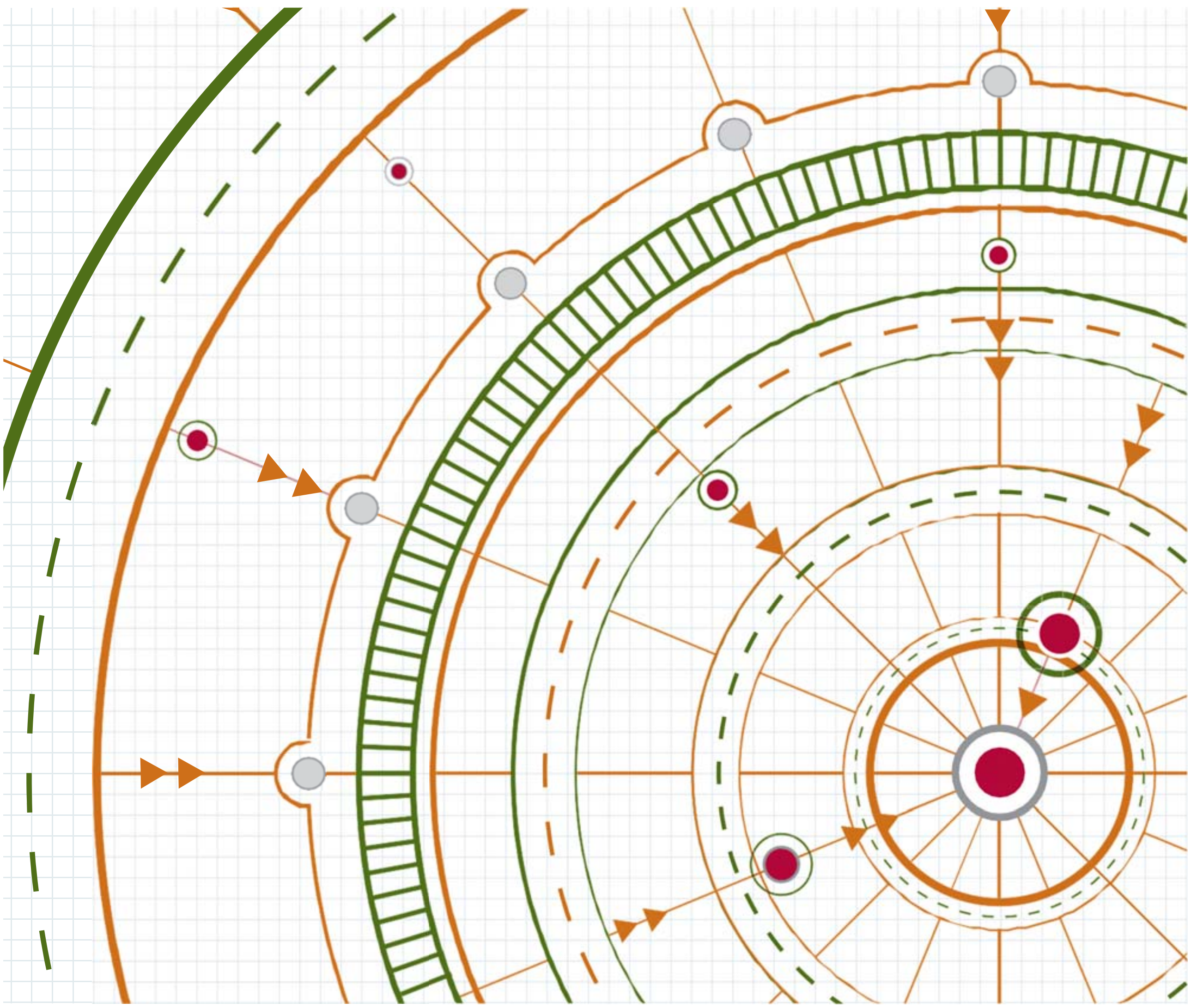
IFRS for SMEs® Standard (2015) + Q&As

IFRS® Foundation—Supporting Material for the *IFRS for SMEs* Standard

Module 30—Foreign Currency Translation



IFRS®

IFRS® Foundation Supporting Material for the *IFRS for SMEs®* Standard

including the full text of
Section 30 *Foreign Currency Translation*
of the *IFRS for SMEs* Standard
issued by the International Accounting Standards Board in October 2015

with extensive explanations, self-assessment questions and case studies

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This module has been prepared by IFRS Foundation (Foundation) education staff. It has not been approved by the International Accounting Standards Board (Board). The module is designed to assist users of the *IFRS for SMEs*® Standard (Standard) to implement and consistently apply the Standard.

Contents

Module 30—Foreign Currency Translation

The accounting requirements applicable to small and medium-sized entities (SMEs) discussed in this module are set out in the *IFRS for SMEs* Standard, issued by the International Accounting Standards Board (Board) in October 2015.
This module has been prepared by IFRS Foundation education staff.
The contents of Section 30 *Foreign Currency Translation* of the *IFRS for SMEs* Standard are set out in this module and shaded grey. The Glossary of terms of the *IFRS for SMEs* 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. The notes and examples inserted by the education staff are not shaded. These notes and examples do not form part of the *IFRS for SMEs* Standard and have not been approved by the Board.

INTRODUCTION

Which version of the *IFRS for SMEs*® Standard?

When the *IFRS for SMEs* Standard was first issued in July 2009, the Board said it would undertake an initial comprehensive review of the Standard to assess entities' experience of the first two years of its application and to consider the need for any amendments. To this end, in June 2012, the Board issued a Request for Information: *Comprehensive Review of the IFRS for SMEs*. An Exposure Draft proposing amendments to the *IFRS for SMEs* Standard was subsequently published in 2013, and in May 2015 the Board issued *2015 Amendments to the International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs* Standard*)*.

The document published in May 2015 only included amended text, but in October 2015, the Board issued a fully revised edition of the Standard, which incorporated additional minor editorial amendments as well as the substantive May 2015 revisions. This module is based on that version.

The *IFRS for SMEs* Standard issued in October 2015 is effective for annual periods beginning on or after 1 January 2017. Earlier application was permitted, but an entity that did so was required to disclose the fact.

Any reference in this module to the *IFRS for SMEs* Standard refers to the version issued in October 2015.

This module

This 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* Standard. It introduces the subject and reproduces the official text along with explanatory notes and examples designed to enhance understanding of the requirements. The module identifies the significant judgements required in applying Section 30. In addition, the module includes questions designed to test your understanding of the requirements and case studies that provides a practical opportunity to apply the requirements to account for foreign currency transactions and to perform foreign currency translations applying the *IFRS for SMEs* Standard.

Module 30—Foreign currency translation

After completing this module, you should, within the context of the *IFRS for SMEs* 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.

IFRS for SMEs Standard

The *IFRS for SMEs* Standard is intended to apply to the general purpose financial statements of entities that do not have public accountability (see Section 1 *Small and Medium-sized Entities*).

The *IFRS for SMEs* Standard is comprised of mandatory requirements and other non-mandatory material.

The non-mandatory material includes:

- a preface, which provides a general introduction to the *IFRS for SMEs* Standard and explains its purpose, structure and authority;
- implementation guidance, which includes illustrative financial statements and a table of presentation and disclosure requirements;
- the Basis for Conclusions, which summarises the Board's main considerations in reaching its conclusions in the *IFRS for SMEs* Standard issued in 2009 and, separately, in the 2015 Amendments; and
- the dissenting opinion of a Board member who did not agree with the issue of the *IFRS for SMEs* Standard in 2009 and the dissenting opinion of a Board member who did not agree with the 2015 Amendments.

In the IFRS for SMEs Standard, Appendix A: Effective date and transition, and Appendix B: Glossary of terms, are part of the mandatory requirements.

In the *IFRS for SMEs* Standard, there are appendices to Section 21 *Provisions and Contingencies*, Section 22 *Liabilities and Equity* and Section 23 *Revenue.* These appendices provide non-mandatory guidance.

The *IFRS for SMEs* Standard has been issued in two parts: Part A contains the preface, all the mandatory material and the appendices to Section 21, Section 22 and Section 23; and Part B contains the remainder of the material mentioned above.

Further, the SME Implementation Group (SMEIG), which assists the Board with supporting implementation of the *IFRS for SMEs* Standard, publishes implementation guidance as ‘questions and answers’ (Q&As). These Q&As provide non-mandatory, timely guidance on specific accounting questions raised with the SMEIG by entities implementing the *IFRS for SMEs* Standard and other interested parties. At the time of issue of this module (October 2018) the SMEIG has not issued any Q&As relevant to this module.

Introduction to the requirements

The objective of general purpose financial statements of a small or medium-sized entity is to provide information about the entity’s financial position, performance and cash flows that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Such users include, for example, owners who are not involved in managing the business, existing and potential creditors and credit rating agencies.

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 since the 2009 *IFRS for SMEs* Standard

The main change to Section 30 of the *IFRS for SMEs* Standard was to clarify that financial instruments that derive their value from a change in a specified foreign exchange rate are excluded from that section, but financial instruments denominated in a foreign currency are not (see paragraph 30.1).

There were also consequential changes to paragraph 30.18(c) to clarify the accounting treatment for exchange differences on translation to a presentation currency.

In addition, this module reproduces other minor editorial changes made by the 2015 Amendments.

Module 30—Foreign currency translation

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 Section 12 *Other Financial Instruments Issues*.

Notes

Foreign activities

An entity is required to determine its functional currency in accordance with paragraphs 30.2–30.5.

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). 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 of terms of the *IFRS for SMEs* Standard (Glossary) as 'an entity that is a subsidiary, associate, joint venture 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.'

Interaction between Section 30 and other sections

The recognition and measurement of elements in financial statements is governed by relevant sections of the *IFRS for SMEs* Standard. For example, property, plant and equipment purchased in a foreign currency is measured and accounted for 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 which accounting policy to apply (either the cost model or the revaluation model). Section 30 deals with translating the relevant amounts into an entity's functional currency or its presentation currency.

Financial instruments denominated in a foreign currency are accounted for in accordance with Section 11 *Basic Financial Instruments* and Section 12 *Other Financial Instruments Issues*. However, in most cases, Section 30 will still apply in translating the amount determined in accordance with Sections 11 and 12 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 accounted for in accordance with Section 12. Section 30 does not apply to these derivatives. It also does not apply when measuring foreign currency items subject to hedge accounting—see Section 12. 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 and 30.23).

Functional currency

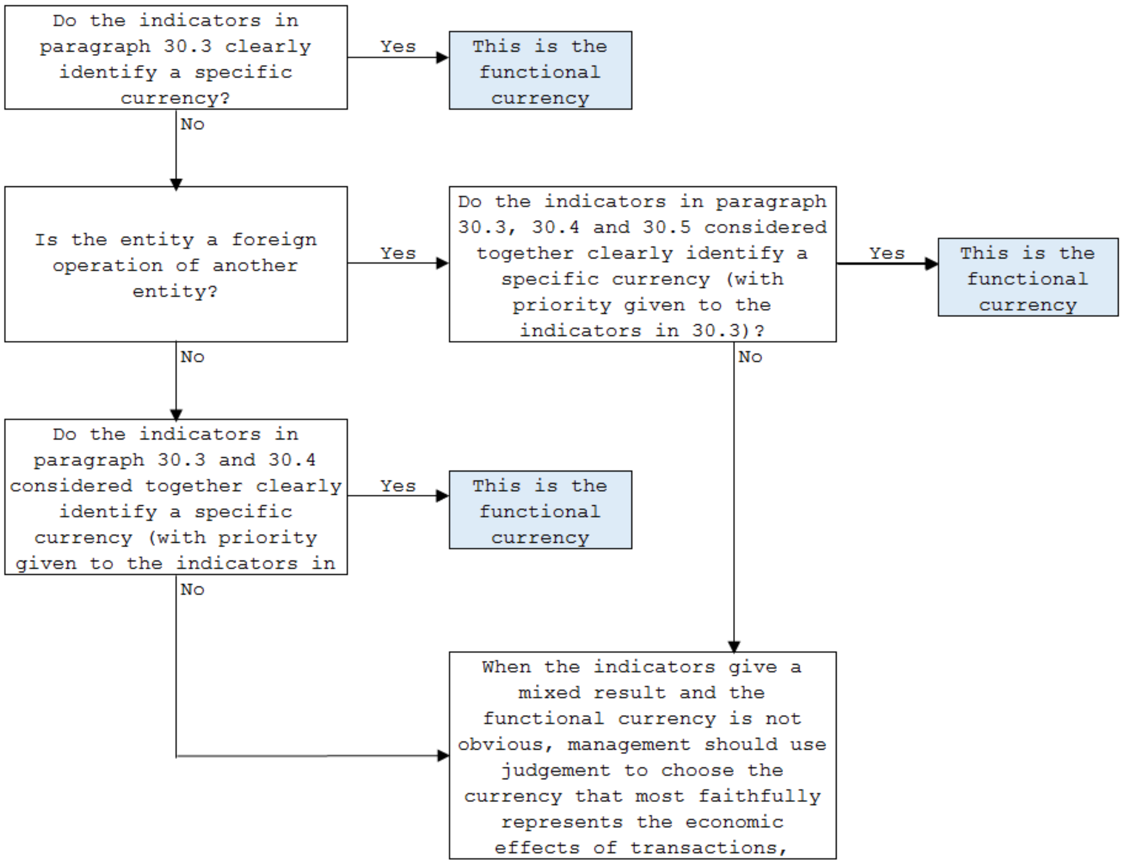
30.2 Each entity shall identify its **functional currency**. An entity's functional currency is the currency of the primary economic environment in which the entity operates.

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 the pricing of which are mostly influenced by 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.

The following flow chart illustrates the approach in determining the functional currency of an entity.



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).

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 and 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 and 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, rather than focusing on 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 entity, 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 entity—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 entity'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 entity's functional currency is the LCA—market forces and regulations in Country A's economy largely determine:

- the selling price of the entity'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 entity's inputs—the entity's inputs are sourced locally and prices are denominated in LCA.

Example—functional currency is not the local currency

Ex 2 **A stand-alone entity 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 entity'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 entity's other costs are incurred and settled in LCA.

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

- the selling price of the entity's output—Country Z is a major contributor to the global market demand for the commodity and the entity's sales are denominated in and settled in LCZ; and
- the costs of the entity's inputs—competitive forces and regulations in Country Z mainly determine the cost price of the entity'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.

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 entity 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 entity's sales prices are nearly always denominated in LCB (the local currency of Country B) and established predominantly based on prices set by competitive forces in Country B and by Country B's regulations. Customers settle in LCB and the entity 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 entity'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 to the LCA-denominated operating costs.

Competitive forces and regulations in Country B are the predominant influences on the sales prices of the entity's products, which indicates that LCB is the entity's functional currency. However, LCA is also indicated as possibly being the entity'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 entity's functional currency because the entity 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 and 30.4 support LCB as the entity'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 venture**):

(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.

Notes

The Glossary defines a foreign operation as an 'entity that is a subsidiary, associate, joint venture 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 ventures are more likely to be operating independently of the investor/venturer (because they are not controlled by the investor/venturer), the indicators in paragraph 30.5 are more likely to be positive for subsidiaries and branches than for associates and joint ventures.

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.

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 service debt obligations), provide supporting evidence that the functional currency is the same as that of the reporting entity.

Integral foreign operations

It would be contradictory for a foreign operation that does business as if it were an extension of a reporting entity's operations to be considered to be operating in a primary economic environment different from that of the reporting entity. Consequently, a foreign operation whose activities are an integral part of those of the reporting entity would be expected to have the same functional currency as 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.

Branches

A foreign operation may be a branch of a reporting entity. Although a branch is legally part of the reporting entity, in substance, it may 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.

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 in Country Z. The subsidiary is predominantly financed by a loan denominated in LCZ (the local currency of Country Z).**

The subsidiary operates with significant autonomy from the parent. Management of the subsidiary determine, without interference from the parent entity, the prices of its products, which are influenced mainly by local competition and regulations. The subsidiary 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 subsidiary. LCZ is the currency in which the sales prices are denominated and settled. In addition, the subsidiary'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 subsidiary'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 subsidiary. The subsidiary does not need to consider the factors in paragraphs 30.4 and 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 a 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 subsidiary is financed mainly by the parent through an LCA-denominated loan. The parent pays the subsidiary 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 subsidiary's only operations are performing research and development activities for the parent entity. The subsidiary'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 subsidiary.

The factors in paragraph 30.4 and 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 would provide support for LCA being the functional currency as follows:

- The activities of the subsidiary 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 subsidiary's activities because the parent pays all the subsidiary's costs.
- Cash flows from the activities of the subsidiary 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 subsidiary other than from the parent to settle the subsidiary'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.

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.

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 on a fair value basis 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.

Notes

On initial recognition, the amount recognised in the foreign currency is determined in conjunction with other relevant sections of the *IFRS for SMEs* Standard before translation 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—an entity sells goods in a foreign currency (paragraph 30.6(a))

Ex 6 **An entity with a functional currency of CU[1] sells inventory with a carrying amount of CU10,000 to a customer on credit for FCU30,000. The spot exchange rate when the sale is recognised in accordance with Section 23 *Revenue* 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).

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).

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

Example—an entity borrows money in a foreign currency (paragraph 30.6(b))

Ex 7 **An entity 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 Credit FCU loan payable—liability		CU40,000

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

Example—an entity buys a machine in a foreign currency (paragraph 30.6(c))

Ex 8 **An entity 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.

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 *IFRS for SMEs* 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 *Revenue* 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 etc. 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. These range 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.

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.

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 *IFRS for SMEs* Standard before translation into the functional currency. For example, if an item of investment property is denominated in a foreign currency (overseas property) and fair value can be measured reliably, the fair value must be determined annually in the foreign currency in accordance with Section 16 *Investment Property* (paragraph 16.7). 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.

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* require 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 it is 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.

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—an entity buys goods on credit in a foreign currency

Ex 9 **On 24 December 20X1, an entity with a functional currency of CU buys raw materials from a supplier on credit for FCU100,000. The entity pays the supplier on 17 January 20X2. The entity 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 × 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 × 2.1 closing rate) minus (FCU100,000 × 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 × 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 × 2.05) minus (FCU100,000 × 2.1)), and the settlement of that monetary item.

Example—foreign currency loan payable

Ex 10 **On 1 January 20X1, a bank transfers FCU5,000 to an entity 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 entity'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**
- **Average exchange rate in 20X1: CU1 = FCU5.06**
- **31 December 20X1: CU1 = FCU5.1**
- **Average exchange rate in 20X2: CU1 = FCU4.9**
- **31 December 20X2: CU1 = FCU4.8**

In this example, the average currency exchange rate for the year is not materially different from the actual rate.

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 entity 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% (see calculation below):

Time	*Carrying amount at 1 January*	*Interest at 8%* [(a)]	*Cash outflow*	*Carrying amount at 31 December*
	FCU	*FCU*	*FCU*	*FCU*
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 ÷ 1.08 + CU5400 ÷ $(1.08)^2$ = CU5,000. Discussion of effective interest rate can be found in Section 11 *Basic Financial Instruments*.

The journal entries are:

<u>**Initial recognition**</u>

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 entity 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 minus CU1,000).

Year ended 31 December 20X2

In 20X2 the entity 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 11 **On 1 June 20X0, an entity 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 entity measures its investment property, after initial recognition, at fair value through profit or loss.

The entity 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) minus (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. However, the entity 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. Alternatively, an entity may choose to account for movement arising from exchange difference separately and present it in aggregate with the fair value gain in the statement of comprehensive income.

Year ended 31 December 20X1

On 31 December 20X1, the investment property is measured at CU450,000 (FCU540,000 ÷ 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 (FCU540,000 ÷ 1.2) minus (FCU520,000 ÷ 1.05)).

The change in fair value in CU includes the foreign exchange loss arising on the change in exchange rate from CU1 = FCU1.05 to CU1 = FCU1.2 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).

Derecognition

On 1 April 20X2 the investment property is sold for CU518,182 (FCU570,000 ÷ 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 (FCU570,000 ÷ 1.1) and respective gain ((FCU570,000 ÷ 1.1) minus (FCU540,000 ÷ 1.2)).

The change in fair value in CU includes the foreign exchange gain arising on the change in exchange rate from CU1 = FCU1.2 to CU1 = FCU1.1 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.

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 *IFRS for SMEs* Standard. Management'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 may be part of the entity's net investment if neither party to the loan intends or expects the loan 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 12 *Other Financial Instruments Issues* 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.

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.

Note: in examples 12–15, 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 12 **On 1 January 20X0, a parent entity (whose functional currency is CU) made a FCU20,000 loan 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 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, if prepared (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).

Note: 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.

Note: 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 FCUs.

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 CUs (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 ÷ FCU2) − (FCU20,000 ÷ FCU2.1)) is presented in other comprehensive income in accordance with paragraph 30.18.

In preparing consolidated financial statements, the intragroup 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 ÷ 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 group's 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.

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

Ex 13 **The facts are the same as in Example 12 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.

Group's 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 pro forma 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 14 **The facts are the same as in Example 12. 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 the foreign currency risk.

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

On consolidation, the intercompany 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 15 **The facts are the same as in Example 14 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 less impairment, or at fair value with changes in fair value recognised in profit or loss.

For the entries related to the loan receivable, see the investor's separate financial statements in Example 14.

Associate's individual financial statements

The entries in the associate's individual financial statements are the same as in Example 14 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). In its financial statements the following entries will be made:

	Scenario 1	*Scenario 2*	Scenario 3
Investor's main financial statements	Except for the recognition of the loan (similar to Example 14), 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 14), 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 14), 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 (1,000 ÷ 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.

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 (in the words of paragraph 30.15, '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 16 **Several years earlier, an entity (parent), whose functional currency is CU, purchased an overseas 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 the current year, 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 17 **Until 31 December 20X2 (its financial year-end) an entity's functional currency was the CU. It presented its financial statements in CU.**

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

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

On 1 January 20X3 the entity 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 entity 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 entity 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 comparatives 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 18 **The facts are the same as in Situation 1 of Example 17. On 1 January 20X0, the entity purchased an item of machinery for FCU100,000 when the exchange rate was CU1 = FCU2. The entity 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 (FCU100,000 ÷ 2).

On 31 December 20X2 three years of depreciation will have been charged on the machine (CU15,000 = CU50,000 ÷ 10 × 3). Consequently, the machine is recorded at CU35,000 (CU50,000 minus CU15,000).

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 (CU35,000 × 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 assess the machine's remaining useful life at seven years and its residual value at zero, then a depreciation expense of FCU9,000 (FCU63,000 ÷ 7) will be recognised each year. Consequently, on 31 December 20X3 the machine will have a carrying amount of FCU54,000 (FCU63,000 minus FCU9,000).

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.

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.

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.

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 19–21, 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 21 illustrates the use of an average rate for a month.

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

Ex 19 **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.**
- **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 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		20X2	20X1		20X1
	CU	Rate[(a)]	LCA	CU	Rate[(a)]	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 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:

	31/12/20X2	31/12/20X1
	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		20X2
	CU		LCA
Revenue	146,114	2.2	321,451
Cost of sales	(113,969)	2.2	(250,732)
Gross profit	**32,145**	2.2	**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**	2.2	**41,789**
Income tax expense	(4,495)	2.2	(9,889)
Profit for the year	**14,500**	2.2	**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 minus 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 20 The facts are the same as in Example 19, 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.

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

	20X2 CU	20X2 LCA@2.3	20X1 CU	20X1 LCA@2
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 19, 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 19.

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. Put simply, this is also the figure that will balance the total assets against total liabilities and equity.

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

Statement of changes in equity 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 21 **The facts are the same as in Example 20, 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.

Notes

Examples 22 and 23 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 22 **The facts are the same as in Example 19.**

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 23 **The facts are the same as in Example 20.**

The difference between the exchange loss of LCA12,700 in Example 19 and the exchange loss of CU9,700 in Example 20 arises from the share capital issue in the year. It increases net assets by CU10,000.

As in Example 22, 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.

Notes

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

Step 1: A parent entity determines its own functional currency. All of the parent entity's foreign currency transactions are recognised in the parent entity's functional currency.

Step 2: The functional currency of each subsidiary is determined. Each subsidiary recognises all of its foreign currency transactions in its functional currency. Each subsidiary prepares financial statements in its functional currency.

Step 3: If the parent entity uses the equity method for investments in associates or jointly controlled entities, or both, it determines the functional currency of each of its associates and jointly controlled entities. Each such entity would have prepared financial statements in its functional currency.

Note: if the parent accounts for investments in associates and joint ventures using the cost model or the fair value model, the normal requirements for non-monetary assets are applied to translate those investments.

Step 4: If the parent entity has branches that have a different functional currency from the functional currency of the parent entity, management determines the functional currency of any such branch. Each branch recognises all of its foreign currency transactions in its functional currency.

Step 5: The financial statements of the parent entity and the financial statements of any subsidiaries, branches, associates (equity method only) or jointly controlled entities (equity method only) in Steps 2–4 are translated into the presentation currency of the consolidated financial statements (the group presentation currency) if their functional currencies differ from the group presentation currency.

The group presentation currency may be the functional currency of the parent entity, or another currency (the choice of presentation currency is free).

Step 6: The translated financial statements of subsidiaries are incorporated into the consolidated financial statements following normal consolidation procedures (the same treatment is applied if any branches are accounted for separately).

Step 7: The translated financial statements of associates and jointly controlled entities (equity method) are incorporated in the consolidated financial statements following equity method procedures.

Exchange differences on intragroup monetary items

See Examples 12–14, 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.

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 *IFRS for SMEs* 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 to 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 *Impairment of Assets* 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).

Example—retranslation of goodwill

Ex 24 **On 31 December 20X0, Entity A (whose functional currency and presentation currency are both the CU) acquires in a business combination a 100% interest in Entity B (whose functional currency is the 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 machine were ignored.)**

Exchange rates are:

- **at 31 December 20X0: CU1 = FCU2; and**
- **at 31 December 20X1: CU = FCU2.1.**

Entity 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[(a)] translation adjustments in equity.

The consolidated statement of comprehensive income includes a foreign exchange loss of CU119[(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)] Calculation: (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, minus 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 25 **The facts are the same as in Example 24. 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. Entity A's consolidated statement of financial position at 31 December 20X1 includes:

- CU429 goodwill (calculation: (FCU1,000 gross minus CU100 amortisation) ÷ 2.1 closing exchange rate); and
- CU1,714 property, plant and equipment [calculation: (FCU4,000 gross minus CU400 depreciation) ÷ 2.1 closing exchange rate]
- 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: FCU1,000 ÷ 10 years = FCU100 amortisation expense. FCU100 amortisation ÷ 2.05 = CU48.78);
- an expense of CU195 presented in profit or loss for the depreciation of equipment (calculation: FCU4,000 ÷ 10 years = FCU400 depreciation expense. FCU400 depreciation ÷ 2.05 = CU195.12);
- 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)] CU22.65[(b)] + CU90.59[(c)] = CU113.24 translation adjustment in equity.

[(b)] Calculation: translation loss for goodwill: FCU1,000 ÷ 2.0 opening exchange rate = CU500 goodwill recognised in the accounting for the business combination minus CU48.78 amortisation expense minus CU428.57 goodwill remaining at 31 December 20X1 (FCU1,000 x 9/10 years = FCU900. FCU900 remaining balance ÷ 2.1 closing exchange rate = CU428.57) = CU22.65.

[(c)] Calculation: translation loss for the subsidiary's other net assets (machine): FCU4,000 ÷ 2.0 opening exchange rate = CU2,000 net assets recognised in the accounting for the business combination minus CU195.12 depreciation expense minus CU1,714.29 group carrying amount remaining at 31 December 20X1 (FCU4,000 x 9/10 years = FCU3,600. FCU3,600 remaining balance ÷ 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 *Basic Financial Instruments* and Section 12; 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 26 **The facts are the same in Example 11. 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 entity 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 follows:

	20X1	20X0
	CU	CU
Opening balance	495,238	–
Additions	–	454,545
Changes in fair value	(45,238)	40,693
	450,000	**495,238**

Included in changes in fair value was a foreign exchange loss of CU63,095 (20X0: foreign exchange gain of CU22,174)[a].

[a] This translation difference can be calculated as follows. It assumes that the changes in fair value is 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.

		20X1	20X0
Opening balance of investment property, at FCU	*A*	520,000	500,000
Closing balance of investment property, at FCU	*B*	540,000	520,000
Fair value gain, at FCU	*C = B – A*	20,000	20,000
Average exchange rate, CU to FCU	*D*	1.12	1.08
Net change in the value of investment property arising from fluctuation in fair value, translated at CU	*E = C / D*	17,857	18,519
Net change in the value of investment property at CU (as reported in the table above)	*F*	(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.

[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 prior period.

The translation difference entity can be separately calculated as follows:

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

Alternatively, an entity 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 follows:

	20X1	20X0
	CU	CU
Opening balance	495,238	–
Additions	–	454,545
Changes in fair value	17,857	18,519
Translation difference – gain (loss)	(63,095)	22,174
	450,000	**495,238**

Ex 27 **An entity 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 28 **A group 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 translations 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 translations 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.

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 28 and 29 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 29 **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.

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 30 **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 reiterates 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 31 **An entity could present the disclosures for the change in the functional currency as follows:**

ABC Group

[Extract from] Notes

Note 2 Accounting policies [extract]

Foreign currency translation [extract]

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.

SIGNIFICANT ESTIMATES AND OTHER JUDGEMENTS

Applying the requirements of the *IFRS for SMEs* Standard to transactions and events often requires the exercise of 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 must disclose the judgements—apart from those involving estimates—that its 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, applying paragraph 8.7, an entity must disclose 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* 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 its functional currency in order to result in a fair presentation (ie 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 establish 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)). Judgement needs to be applied 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)).

Module 30—Foreign currency translation

COMPARISON WITH FULL IFRS STANDARDS

The following are the primary differences at October 2015 between the requirements for accounting for foreign currency transactions and foreign activity in accordance with full IFRS Standards (see IAS 21 *The Effects of Changes in Foreign Exchange Rates*) and the *IFRS for SMEs* Standard (see Section 30 *Foreign Currency Translation*):

- The *IFRS for SMEs* Standard is drafted in simple language with less application guidance than is provided in full IFRS Standards.
- The *IFRS for SMEs* 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.
- The *IFRS for SMEs* Standard does not have specific procedures for the translation of the results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy into a different presentation currency, while IAS 21 does have such procedures.

Module 30—Foreign currency translation

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 applying the *IFRS for SMEs* 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 set out beneath it.

Mark the box that represents the most correct answer.

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 venture):

- ☐ (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

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) Debit Inventory CU3,000

Credit Profit or loss (exchange difference) CU3,000

Debit Profit or loss (exchange difference) CU3,000

Credit 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;

Debit Profit or loss (exchange difference) CU3,000

Credit 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) Debit Inventory CU3,000

Credit 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 6

The facts are the same as in Question 5. 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?

☐ (a) Debit Trade payable CU23,000

Credit Profit or loss (exchange difference) CU5,000

Credit Cash CU18,000.

☐ (b) Debit Trade payable CU20,000

Credit Profit or loss (exchange difference) CU2,000

Credit Cash CU18,000.

☐ (c) Debit Trade payable CU23,000

Credit Cash CU23,000.

☐ (d) Debit Trade Payable CU18,000

Credit Cash CU18,000.

Question 7

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

☐ (a) ten-year loan from a parent to its foreign subsidiary for which the parent intends enforcing repayment when it is due.

☐ (b) loan made from a parent to its foreign subsidiary which is payable on demand.

☐ (c) trade receivables or trade payables between a parent and its subsidiary.

☐ (d) 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 8

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

☐ (a) apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

☐ (b) apply the translation procedures applicable to the new functional currency retrospectively.

☐ (c) disclose the fact that the entity's functional currency has changed and the reason for that change.

☐ (d) both (a) and (c) are required.

Question 9

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 10

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 the CU.

Spot currency exchange rates:

- 1 January 20X0: FCU1 = CU2;
- Weighted average exchange rate in 20X0: FCU1 = CU2.04;
- 31 December 20X0: FCU1 = CU2.1.

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) (a) or (b) provided the entity also comply with the disclosure requirement in paragraph 30.25(a).

Question 11

The facts are the same as in Question 10. 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.

Module 30—Foreign currency translation

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 (c)—see paragraphs 30.9 and 30.10.
Q6 (a)—see paragraphs 30.9 and 30.10.
Q7 (d)—see paragraph 30.12.
Q8 (d)—see paragraphs 30.14 and 30.27.
Q9 (d)—see paragraph 30.18.
Q10 (e)—see paragraphs 30.9(c) and 30.25(a).
Q11 (c)—see paragraph 30.9(b).

Module 30—Foreign currency translation

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* Standard, by completing the case studies below.

Once you have completed the case study, check your answers against those set out beneath it.

Case study 1

A parent entity has two subsidiaries, 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 entity prices its products in CU, most of the parent's 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 entity 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.

Module 30—Foreign currency translation

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 hence 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.
- 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 entity whose functional currency is CU buys a retail outlet in another country (local currency = 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 entity performed an impairment test. It determined the recoverable amount of the outlet to be FCU550,000.

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

Spot currency exchange rates:

- 1 March 20X0: CU1 = FCU2;
- 1 March 20X0 to 31 December 20X0 (average rate): CU1 = FCU2.2;
- 31 December 20X0: CU1 = FCU2.4;
- 1 January 20X1 to 28 February 20X1 (average rate): CU1 = FCU2.3;
- 28 February 20X1: CU1 = FCU2.1; and
- 31 December 20X1: CU1 = FCU2.5.

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

Module 30—Foreign currency translation

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 entity 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) minus 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) minus CU250,000.

In 20X0, the entity 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 ÷ 12 months × 10 months).

On 31 December 20X0, cost minus depreciation is CU239,583 (CU250,000 minus 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 entity'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 cost minus 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) minus (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 entity 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 (FCU300,000 ÷ 2.5). The carrying amount of the outlet without considering impairment on 31 December 20X1 is CU217,210 (CU229,167 minus CU11,957). The recoverable amount is lower than the carrying amount of the outlet on 31 December 20X1 and so the entity 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 minus 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

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

Statement of comprehensive income for the year ended 31 December

	20X1	*20X0*
	CU	*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	*20X0*
	CU	*CU*
Cash flows from operating activities		
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
Cash flows from investing activity		
Cash paid for a purchase of property, plant and equipment	–	(900)
Cash flows from financing activity		
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

	Share capital	*Retained earnings*	*Total*
	CU	*CU*	*CU*
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

Additional information:

The following spot currency exchange rates apply:

- 1 January 20X0: CU1 = ACU2;
- 31 December 20X0: CU1 = ACU1.95;
- 31 December 20X1: CU1 = ACU2.1;
- Weighted average for 20X0: CU1 = ACU2.11;
- Weighted average for 20X1: CU1 = ACU1.79;
- When the income tax was paid in 20X1: CU1 = ACU2.05; and
- When equipment was bought and paid for in 20X0: CU1 = ACU1.9

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 entity's functional currency (CU) to the entity'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
	1,784		3,746.4	1,520		2,964
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	259		543.9	226	1.95	440.7
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
	1,525		3,202.5	1,294		2,523.3
Total liabilities and equity	1,784		3,746.4	1,520		2,964

Translation to the presentation currency—statement of comprehensive income

	20X1			**20X0**		
	CU	*Rate*	*ACU*	*CU*	*Rate*	*ACU*
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 flows[3]

	20X1			20X0		
	CU	Rate	ACU	CU	Rate	ACU
Cash flows from operating activities						
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
Cash flows from investing activity						
Cash paid for a purchase of property, plant and equipment	–		–	(900)	1.9	(1,710.0)
Cash flows from financing activity						
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

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

	Share capital	*Foreign exchange reserve*	*Retained earnings*	*Total*
	ACU	*ACU*	*ACU*	*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

Case study 4

On 1 January 20X1 ABC Co purchased 100% of the equity of ABC Sub for FCU2,000 when the fair value of ABC Sub'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 ABC Group consists of a parent company (ABC Co) and its subsidiary (ABC Sub).

ABC Co's functional currency is the CU and ABC Sub's FCU.

On 2 February 20X1 when the exchange rate was CU1 = FCU2.1, ABC Co advanced a loan of FCU200 to ABC Sub. ABC Co informed ABC Sub that it did not expect to demand repayment for the foreseeable future and ABC Sub 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.

ABC Co'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:

ABC Co's statement of financial position at

	31 December 20X0	*31 December 20X1*
	CU	*CU*
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
	3,700	3,716
Trade and other payables	400	300
Bank loan	1,500	1,500
Total liabilities	1,900	1,800
Share capital	1,000	1,000
Retained earnings	800	916
	1,800	1,916
Total liabilities and equity	3,700	3,716

ABC Co's statement of comprehensive income for the year ended 31 December 20X1

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

ABC Sub'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:

ABC Sub's statement of financial position at

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

ABC Sub's statement of comprehensive income for the year ended 31 December 20X1

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

Prepare the ABC Co'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 ABC Co's consolidated financial statements is the CU.
- ABC Sub'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 ABC Sub by ABC Co in accordance with Section 9 *Consolidated and Separate Financial Statements*. In other words, ABC Sub'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 ABC Sub'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 ABC Co's profit or loss and was presented in ABC Co's finance costs in its statement of comprehensive income.
    - Translate ABC Sub's share capital using the exchange rate on the date when ABC Co acquired ABC Sub.

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 minus CU4)	(30)	(e)
Profit for the year	144	
Other comprehensive income		
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 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 expanse of parent) minus CU4 (foreign exchange difference on intragroup loan).

Translation of subsidiary to the presentation currency:

ABC Sub's statement of financial position at 31 December 20X1 translated into CU

	FCU	*Rate*	*CU*	
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 ABC Sub has the shares already issued before the acquisition of ABC Co. That exchange rate—when the shares were originally issued—was not used but, instead, the exchange rate at the date when ABC Co acquire ABC Sub was used in translating the former's share capital because, from the perspective of ABC Co, this is the relevant rate in its financial statements.

(f) Retained earnings—CU calculation: CU134 = (FCU200 opening balance ÷ 2 using CU1 = FCU2 exchange rate at the date when ABC Co acquire ABC Sub) + (FCU70 profit for 20X1 ÷ 2.05 using CU1 = FCU2.05 average rate).

ABC Sub'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

Calculation of foreign exchange loss (CU84):

(g) 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**