

International Accounting Standard 21

The Effects of Changes in Foreign Exchange Rates

This version includes amendments resulting from IFRSs issued up to 31 December 2008.

IAS 21 *The Effects of Changes in Foreign Exchange Rates* was issued by the International Accounting Standards Committee in December 1993. It replaced IAS 21 *Accounting for the Effects of Changes in Foreign Exchange Rates* (issued in July 1983).

Limited amendments were made to cross-references in IAS 21 in 1998 and 1999.

The Standing Interpretations Committee developed four Interpretations relating to IAS 21:

- SIC-7 *Introduction of the Euro* (issued May 1998)
- SIC-11 *Foreign Exchange—Capitalisation of Losses Resulting from Severe Currency Devaluations* (issued July 1998)
- SIC-19 *Reporting Currency—Measurement and Presentation of Financial Statements under IAS 21 and IAS 29* (issued November 2000)
- SIC-30 *Reporting Currency—Translation from Measurement Currency to Presentation Currency* (issued December 2001).

In April 2001 the International Accounting Standards Board (IASB) resolved that all Standards and Interpretations issued under previous Constitutions continued to be applicable unless and until they were amended or withdrawn.

In December 2003 the IASB issued a revised IAS 21. The revised standard also amended SIC-7, to which IAS 21 still refers, and replaced SIC-11, SIC-19 and SIC-30.

Since 2003, IAS 21 and its accompanying documents have been amended by the following IFRSs:

- *Net Investment in a Foreign Operation (Amendment to IAS 21)* (issued December 2005)
- *IAS 1 Presentation of Financial Statements* (as revised in September 2007)*
- *IAS 27 Consolidated and Separate Financial Statements* (as amended in January 2008)†
- *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendments to IFRS 1 and IAS 27)* (issued May 2008).‡

The following Interpretation refers to IAS 21:

- IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* (issued July 2008).§

* effective date 1 January 2009

† effective date 1 July 2009

§ effective date 1 October 2008

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International Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (IAS 21) is set out in paragraphs 1–62 and the Appendix. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. IAS 21 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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Introduction

IN1 International Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (IAS 21) replaces IAS 21 *The Effects of Changes in Foreign Exchange Rates* (revised in 1993), and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. The Standard also replaces the following Interpretations:

- SIC-11 *Foreign Exchange—Capitalisation of Losses Resulting from Severe Currency Devaluations*
- SIC-19 *Reporting Currency—Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*
- SIC-30 *Reporting Currency—Translation from Measurement Currency to Presentation Currency*.

Reasons for revising IAS 21

- IN2 The International Accounting Standards Board developed this revised IAS 21 as part of its project on Improvements to International Accounting Standards. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the project were to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements.
- IN3 For IAS 21 the Board's main objective was to provide additional guidance on the translation method and on determining the functional and presentation currencies. The Board did not reconsider the fundamental approach to accounting for the effects of changes in foreign exchange rates contained in IAS 21.

The main changes

- IN4 The main changes from the previous version of IAS 21 are described below.

Scope

- IN5 The Standard excludes from its scope foreign currency derivatives that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*. Similarly, the material on hedge accounting has been moved to IAS 39.

Definitions

- IN6 The notion of 'reporting currency' has been replaced with two notions:
- functional currency, ie the currency of the primary economic environment in which the entity operates. The term 'functional currency' is used in

place of ‘measurement currency’ (the term used in SIC-19) because it is the more commonly used term, but with essentially the same meaning.

- presentation currency, ie the currency in which financial statements are presented.

Definitions—functional currency

- IN7 When a reporting entity prepares financial statements, the Standard requires each individual entity included in the reporting entity—whether it is a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch)—to determine its functional currency and measure its results and financial position in that currency. The new material on functional currency incorporates some of the guidance previously included in SIC-19 on how to determine a measurement currency. However, the Standard gives greater emphasis than SIC-19 gave to the currency of the economy that determines the pricing of transactions, as opposed to the currency in which transactions are denominated.
- IN8 As a result of these changes and the incorporation of guidance previously in SIC-19:
- an entity (whether a stand-alone entity or a foreign operation) does not have a free choice of functional currency.
 - an entity cannot avoid restatement in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies* by, for example, adopting a stable currency (such as the functional currency of its parent) as its functional currency.
- IN9 The Standard revises the requirements in the previous version of IAS 21 for distinguishing between foreign operations that are integral to the operations of the reporting entity (referred to below as ‘integral foreign operations’) and foreign entities. The requirements are now among the indicators of an entity’s functional currency. As a result:
- there is no distinction between integral foreign operations and foreign entities. Rather, an entity that was previously classified as an integral foreign operation will have the same functional currency as the reporting entity.
 - only one translation method is used for foreign operations—namely that described in the previous version of IAS 21 as applying to foreign entities (see paragraph IN13).
 - the paragraphs dealing with the distinction between an integral foreign operation and a foreign entity and the paragraph specifying the translation method to be used for the former have been deleted.

Reporting foreign currency transactions in the functional currency—recognition of exchange differences

- IN10 The Standard removes the limited option in the previous version of IAS 21 to capitalise exchange differences resulting from a severe devaluation or depreciation of a currency against which there is no means of hedging. Under the Standard, such exchange differences are now recognised in profit or loss. Consequently, SIC-11, which outlined restricted circumstances in which such exchange differences may be capitalised, has been superseded since capitalisation of such exchange differences is no longer permitted in any circumstances.

Reporting foreign currency transactions in the functional currency—change in functional currency

- IN11 The Standard replaces the previous requirement for accounting for a change in the classification of a foreign operation (which is now redundant) with a requirement that a change in functional currency is accounted for prospectively.

Use of a presentation currency other than the functional currency—translation to the presentation currency

- IN12 The Standard permits an entity to present its financial statements in any currency (or currencies). For this purpose, an entity could be a stand-alone entity, a parent preparing consolidated financial statements or a parent, an investor or a venturer preparing separate financial statements in accordance with IAS 27 *Consolidated and Separate Financial Statements*.
- IN13 An entity is required to translate its results and financial position from its functional currency into a presentation currency (or currencies) using the method required for translating a foreign operation for inclusion in the reporting entity's financial statements. Under this method, assets and liabilities are translated at the closing rate, and income and expenses are translated at the exchange rates at the dates of the transactions (or at the average rate for the period when this is a reasonable approximation).
- IN14 The Standard requires comparative amounts to be translated as follows:
- (a) for an entity whose functional currency is not the currency of a hyperinflationary economy:
 - (i) assets and liabilities in each statement of financial position presented are translated at the closing rate at the date of that statement of financial position (ie last year's comparatives are translated at last year's closing rate).
 - (ii) income and expenses in each statement of comprehensive income or separate income statement presented are translated at exchange rates at the dates of the transactions (ie last year's comparatives are translated at last year's actual or average rate).
 - (b) for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are translated into the currency of a different hyperinflationary economy, all

amounts (eg amounts in a statement of financial position and statement of comprehensive income) are translated at the closing rate of the most recent statement of financial position presented (ie last year's comparatives, as adjusted for subsequent changes in the price level, are translated at this year's closing rate).

- (c) for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are translated into the currency of a non-hyperinflationary economy, all amounts are those presented in the prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

This translation method, like that described in paragraph IN13, applies when translating the financial statements of a foreign operation for inclusion in the financial statements of the reporting entity, and when translating the financial statements of an entity into a different presentation currency.

Use of a presentation currency other than the functional currency—translation of a foreign operation

- IN15 The Standard requires goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity to be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate.

Disclosure

- IN16 The Standard includes most of the disclosure requirements of SIC-30. These apply when a translation method different from that described in paragraphs IN13 and IN14 is used or other supplementary information (such as an extract from the full financial statements) is displayed in a currency other than the functional currency or the presentation currency.
- IN17 In addition, entities must disclose when there has been a change in functional currency, and the reasons for the change.

International Accounting Standard 21

The Effects of Changes in Foreign Exchange Rates

Objective

- 1 An entity may carry on 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. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.
- 2 The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

Scope

- 3 **This Standard shall be applied:**
 - (a) **in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement*;**
 - (b) **in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation or the equity method; and**
 - (c) **in translating an entity's results and financial position into a presentation currency.**
- 4 IAS 39 applies to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of IAS 39 (eg some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.
- 5 This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. IAS 39 applies to hedge accounting.
- 6 This Standard applies to the presentation of an entity's financial statements in a foreign currency and sets out requirements for the resulting financial statements to be described as complying with International Financial Reporting Standards (IFRSs). For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.
- 7 This Standard does not apply to the presentation in a statement of cash flows of the cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (see IAS 7 *Statement of Cash Flows*).

* See also SIC-7 *Introduction of the Euro*.

Definitions

8 The following terms are used in this Standard with the meanings specified:

Closing rate is the spot exchange rate at the end of the reporting period.

Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

Exchange rate is the ratio of exchange for two currencies.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Foreign currency is a currency other than the functional currency of the entity.

Foreign operation is 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.

Functional currency is the currency of the primary economic environment in which the entity operates.

A group is a parent and all its subsidiaries.

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.

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

Presentation currency is the currency in which the financial statements are presented.

Spot exchange rate is the exchange rate for immediate delivery.

Elaboration on the definitions

Functional currency

9 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors 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).

- 10 The following factors may also provide evidence of an entity's functional currency:
- (a) the currency in which funds from financing activities (ie issuing debt and equity instruments) are generated.
 - (b) the currency in which receipts from operating activities are usually retained.
- 11 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, rather than 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.
- 12 When the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 9 before considering the indicators in paragraphs 10 and 11, which are designed to provide additional supporting evidence to determine an entity's functional currency.
- 13 An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.
- 14 If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies*. An entity cannot avoid restatement in accordance with IAS 29 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its parent).