

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 ⁽¹⁾:
 - (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 (e.g. 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. 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 cash-flow statement of cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (see IAS 7 *Cash-flow statements*).

DEFINITIONS

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

Closing rate is the spot exchange rate at the balance sheet date.

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.

⁽¹⁾ See also SIC-7 *Introduction of the euro*.

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 (i.e. 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).

Net investment in a foreign operation

- 15 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 paragraphs 32 and 33. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.
- 15A The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 15 may be any subsidiary of the group. For example, an entity has two subsidiaries, A and B. Subsidiary B is a foreign operation. Subsidiary A grants a loan to Subsidiary B. Subsidiary A's loan receivable from Subsidiary B would be 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. This would also be true if Subsidiary A were itself a foreign operation.

Monetary items

- 16 The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: pensions and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends that are recognised as a liability. Similarly, a contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (e.g. prepaid rent); goodwill; intangible assets; inventories; property, plant and equipment; and provisions that are to be settled by the delivery of a non-monetary asset.

SUMMARY OF THE APPROACH REQUIRED BY THIS STANDARD

- 17 In preparing financial statements, each entity — whether a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch) — determines its functional currency in accordance with paragraphs 9-14. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 20-37 and 50.
- 18 Many reporting entities comprise a number of individual entities (e.g. a group is made up of a parent and one or more subsidiaries). Various types of entities, whether members of a group or otherwise, may have investments in associates or joint ventures. They may also have branches. It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This standard permits the presentation currency of a reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 38-50.
- 19 This standard also permits a stand-alone entity preparing financial statements or an entity preparing separate financial statements in accordance with IAS 27 *Consolidated and separate financial statements* to present its financial statements in any currency (or currencies). If the entity's presentation currency differs from its functional currency, its results and financial position are also translated into the presentation currency in accordance with paragraphs 38-50.

REPORTING FOREIGN CURRENCY TRANSACTIONS IN THE FUNCTIONAL CURRENCY

Initial recognition

- 20 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.
- 21 A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.
- 22 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with international financial reporting standards. 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.

Reporting at subsequent balance sheet dates

- 23 At each balance sheet date:
- (a) foreign currency monetary items shall be translated using the closing rate;
 - (b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and
 - (c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined.
- 24 The carrying amount of an item is determined in conjunction with other relevant standards. For example, property, plant and equipment may be measured in terms of fair value or historical cost in accordance with IAS 16 *Property, plant and equipment*. Whether the carrying amount is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this standard.
- 25 The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories is the lower of cost and net realisable value in accordance with IAS 2 *Inventories*. Similarly, in accordance with IAS 36 *Impairment of assets*, the carrying amount of an asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable amount. When such an asset is non-monetary and is measured in a foreign currency, the carrying amount is determined by comparing:
- (a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (i.e. the rate at the date of the transaction for an item measured in terms of historical cost); and
 - (b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date when that value was determined (e.g. the closing rate at the balance sheet date).
- The effect of this comparison may be that an impairment loss is recognised in the functional currency but would not be recognised in the foreign currency, or vice versa.
- 26 When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

Recognition of exchange differences

- 27 As noted in paragraph 3, IAS 39 applies to hedge accounting for foreign currency items. The application of hedge accounting requires an entity to account for some exchange differences differently from the treatment of exchange differences required by this standard. For example, IAS 39 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge are reported initially in equity to the extent that the hedge is effective.

- 28 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 financial statements shall be recognised in profit or loss in the period in which they arise, except as described in paragraph 32.
- 29 When monetary items arise from a foreign currency transaction and there is a change in the exchange rate 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, all 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 during each period.
- 30 When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss shall be recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.
- 31 Other standards require some gains and losses to be recognised directly in equity. For example, IAS 16 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognised directly in equity. When such an asset is measured in a foreign currency, paragraph 23(c) of this standard requires the revalued amount to be translated using the rate at the date the value is determined, resulting in an exchange difference that is also recognised in equity.
- 32 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (see paragraph 15) 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 (e.g. consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in a separate component of equity and recognised in profit or loss on disposal of the net investment in accordance with paragraph 48.
- 33 When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 28. If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements in accordance with paragraph 28. If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements in accordance with paragraph 28. Such exchange differences are reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (i.e. financial statements in which the foreign operation is consolidated, proportionately consolidated or accounted for using the equity method).
- 34 When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial statements all amounts are translated into the functional currency in accordance with paragraphs 20-26. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate, and non-monetary items that are measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition.

Change in functional currency

- 35 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.
- 36 As noted in paragraph 13, 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.
- 37 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. Exchange differences arising from the translation of a foreign operation previously classified in equity in accordance with paragraphs 32 and 39(c) are not recognised in profit or loss until the disposal of the operation.

USE OF A PRESENTATION CURRENCY OTHER THAN THE FUNCTIONAL CURRENCY

Translation to the presentation currency

- 38 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. 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.
- 39 The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
- (a) assets and liabilities for each balance sheet presented (i.e. including comparatives) shall be translated at the closing rate at the date of that balance sheet;
 - (b) income and expenses for each income statement (i.e. including comparatives) shall be translated at exchange rates at the dates of the transactions; and
 - (c) all resulting exchange differences shall be recognised as a separate component of equity.
- 40 For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
- 41 The exchange differences referred to in paragraph 39(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. Such exchange differences arise both on income and expense items recognised in profit or loss and on those recognised directly in equity;
 - (b) translating the opening net assets at a closing rate that differs from the previous closing rate.
- These exchange differences are not recognised in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. 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 minority interests are allocated to, and recognised as part of, minority interest in the consolidated balance sheet.
- 42 The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
- (a) all amounts (i.e. assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent balance sheet; except that
 - (b) when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (i.e. not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).
- 43 When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with IAS 29 before applying the translation method set out in paragraph 42, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy (see paragraph 42(b)). When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements in accordance with IAS 29, it shall use as the historical costs for translation into the presentation currency the amounts restated to the price level at the date the entity ceased restating its financial statements.

Translation of a foreign operation

- 44 Paragraphs 45-47, in addition to paragraphs 38-43, apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation, proportionate consolidation or the equity method.
- 45 The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see IAS 27 and IAS 31 *Interests in joint ventures*). 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 of the reporting entity, such an exchange difference continues to be recognised in profit or loss or, if it arises from the circumstances described in paragraph 32, it is classified as equity until the disposal of the foreign operation.

- 46 When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. When this is not done, IAS 27 allows the use of a different reporting date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the balance sheet date of the foreign operation. Adjustments are made for significant changes in exchange rates up to the balance sheet date of the reporting entity in accordance with IAS 27. The same approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation to joint ventures in accordance with IAS 28 *Investments in associates* and IAS 31.
- 47 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 paragraphs 39 and 42.

Disposal of a foreign operation

- 48 On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that foreign operation shall be recognised in profit or loss when the gain or loss on disposal is recognised.
- 49 An entity may dispose of its interest in a foreign operation through sale, liquidation, repayment of share capital or abandonment of all, or part of, that entity. The payment of a dividend is part of a disposal only when it constitutes a return of the investment, for example when the dividend is paid out of pre-acquisition profits. In the case of a partial disposal, only the proportionate share of the related accumulated exchange difference is included in the gain or loss. A write-down of the carrying amount of a foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised in profit or loss at the time of a write-down.

TAX EFFECTS OF ALL EXCHANGE DIFFERENCES

- 50 Gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency may have tax effects. IAS 12 *Income taxes* applies to these tax effects.

DISCLOSURE

- 51 In paragraphs 53 and 55-57 references to 'functional currency' apply, in the case of a group, to the functional currency of the parent.
- 52 An entity shall disclose:
- (a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with IAS 39; and
 - (b) net exchange differences classified in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
- 53 When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.
- 54 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.

- 55 When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with international financial reporting standards only if they comply with all the requirements of each applicable standard and each applicable interpretation of those standards, including the translation method set out in paragraphs 39 and 42.
- 56 An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 55. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with international financial reporting standards and the disclosures set out in paragraph 57 are required.
- 57 When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 55 are not met, it shall:
- clearly identify the information as supplementary information to distinguish it from the information that complies with international financial reporting standards;
 - disclose the currency in which the supplementary information is displayed; and
 - disclose the entity's functional currency and the method of translation used to determine the supplementary information.

EFFECTIVE DATE AND TRANSITION

- 58 An entity shall apply this standard for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. If an entity applies this standard for a period beginning before 1 January 2005, it shall disclose that fact.
- 58A *Net investment in a foreign operation* (amendment to IAS 21), issued in December 2005, added paragraph 15A and amended paragraph 33. An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.
- 59 An entity shall apply paragraph 47 prospectively to all acquisitions occurring after the beginning of the financial reporting period in which this standard is first applied. Retrospective application of paragraph 47 to earlier acquisitions is permitted. For an acquisition of a foreign operation treated prospectively but which occurred before the date on which this standard is first applied, the entity shall not restate prior years and accordingly may, when appropriate, treat goodwill and fair value adjustments arising on that acquisition as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.
- 60 All other changes resulting from the application of this standard shall be accounted for in accordance with the requirements of IAS 8 *Accounting policies, changes in accounting estimates and errors*.

WITHDRAWAL OF OTHER PRONOUNCEMENTS

- 61 This standard supersedes IAS 21 *The effects of changes in foreign exchange rates* (revised in 1993).
- 62 This standard supersedes 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*; and
 - SIC-30 *Reporting currency — translation from measurement currency to presentation currency*.