IAS 21 AND IAS 29

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IAS 21 - The Effects of Changes in Foreign Exchange Rates

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- 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.

- 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.

The standard shall <u>be applied</u>:

- In accounting for transactions and balances in foreign currencies;
- In translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation or the equity method; and
- In translating an entity's results and financial position into a presentation currency.

The standard shall not be applied to:

- Derivative transactions and balances that are within the scope of IFRS 9 Financial Instruments;
- Hedge accounting for foreign currency items; and
- 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 (IAS 7 Statement of Cash Flows).

The functional currency is the currency in which an entity operates and in which it primarily generates and expends cash.

An entity considers mainly the following factors in determining its functional currency:

- The currency that mainly influences sales prices for goods and services;
- The currency of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services;
- The currency that mainly influences labour, material and other costs of providing goods or services;
- The currency in which funds from financing activities (ie issuing debt and equity instruments) are generated; &
- The currency in which receipts from operating activities are usually retained.

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.

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.

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Monetary Items

A right to receive (or an obligation to deliver) a fixed or determinable number of units of currency such as receivables, payables, cash, lease liabilities, etc…

Non-Monetary Items

The absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency such as: goodwill, intangible assets, inventories, property, plant and equipment, right of use assets, etc…

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Initial Recognition

A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

- Buys or sells goods or services whose price is denominated in a foreign currency.
- Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency.
- Acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

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IAS 21 – REPORTING FOREIGN CURRENCY TRANSACTIONS IN THE FUNCTIONAL CURRENCY

A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the <u>spot exchange rate</u> between the functional currency and the foreign currency at the date of the transaction.

Subsequent reporting at the ends of periods

Foreign currency **monetary items** shall be translated using the **closing rate**;

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

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 measured**.

IAS 21 – RECOGNITION OF EXCHANGE DIFFERENCES

Settlement of monetary items or on translating monetary items

Gain or loss on a non-monetary item

Recognized in

Profit or loss

Profit or loss / Other Comprehensive Income

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Monetary item that forms part of a reporting entity's net investment in a foreign operation

Recognized in

Profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate.

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Consolidated financial statements when the foreign operation is a subsidiary

Recognized in

Initially in other comprehensive income and reclassified from equity to profit or loss on disposal of the net investment.

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Change in an entity's functional currency

The translation procedures applicable to the new functional currency should be applied prospectively from the date of the change.

IAS 21 – TRANSLATION OF A FOREIGN OPERATION

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.

IAS 21 – DISPOSAL OR PARTIAL DISPOSAL OF A FOREIGN OPERATION

An entity may dispose or partially 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 cumulative amount of the exchange differences relating to that foreign operation, recognized in other comprehensive income and accumulated in the separate component of equity, shall be reclassified from equity to profit or loss (as a reclassification adjustment) when the gain or loss on disposal is recognized.

An entity shall disclose:

a) The amount of exchange differences recognized in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with IFRS 9; and

b) Net exchange differences recognized in other comprehensive income and accumulated in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

IAS 29 - Financial Reporting in Hyperinflationary Economies

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This standard shall be applied to the financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.

Hyperinflation

- Interest rates, wages and prices are linked to a price index
- The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency
- The cumulative inflation rate over three years is approaching, or exceeds, 100%
- Amounts of local currency held are immediately invested to maintain purchasing power

The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy, whether they are based on a historical cost approach or a current cost approach, shall be stated in terms of the measuring unit current at the end of the reporting period.

The corresponding figures for the previous period required by IAS 1 Presentation of Financial Statements (as revised in 2007) and any information in respect of earlier periods shall also be stated in terms of the measuring unit current at the end of the reporting period.

For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 42(b) and 43 of IAS 21 The Effects of Changes in Foreign Exchange Rates apply.

The gain or loss on the net monetary position shall be included in profit or loss and separately disclosed.

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Non-Monetary Items

Restated

By applying a general price index.

Monetary Items

Not Restated

Already expressed in terms of the monetary unit current at the end of the reporting period.

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IAS 29 - STATEMENT OF FINANCIAL POSITION

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- ✓ The restated amount is reduced in accordance with appropriate IFRSs, when it exceeds its recoverable amount or its net realizable value.

- ✓ At the beginning of the first period of application of this Standard, the components of owners' equity, <u>except retained earnings and any revaluation surplus</u>, are restated by applying a general price index from the dates the components were contributed or otherwise arose.

- ✓ At the end of the first period and in subsequent periods, all components of owners' equity are restated by applying a general price index from the beginning of the period or the date of contribution.

Income and Expense items need to be restated by applying the change in the general price index from the dates when these were initially recorded in the financial statements.

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Gain or loss on net monetary position

Derived as

The difference resulting from the restatement of non-monetary assets, owners' equity and items in the statement of comprehensive income and the adjustment of index linked assets and liabilities

- ✓ The gain or loss on the net monetary position is included in profit or loss.

- A parent that reports in the currency of a hyperinflationary economy may have subsidiaries that also report in the currencies of hyperinflationary economies.

- The financial statements of any such subsidiary need to be restated by applying a general price index of the country in whose currency it reports before they are included in the consolidated financial statements issued by its parent.

- ✓ Where such a subsidiary is a foreign subsidiary, its restated financial statements are translated at closing rates.

- ✓ The financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21.

The restatement of financial statements in accordance with this Standard requires the use of a general price index that reflects changes in general purchasing power.

IAS 29 – ECONOMIES CEASING TO BE HYPERINFLATIONARY

When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this Standard, it shall treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.

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The following disclosures shall be made:

a) The fact that the financial statements and the corresponding figures for previous periods have been restated for the changes in the general purchasing power of the functional currency and, as a result, are stated in terms of the measuring unit current at the end of the reporting period;

b) Whether the financial statements are based on a historical cost approach or a current cost approach; and

c) The identity and level of the price index at the end of the reporting period and the movement in the index during the current and the previous reporting period.