HKAS 21
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Hong Kong Accounting Standard 21

The Effects of Changes in Foreign Exchange Rates

Hong Kong Institute of
Certified Public Accountants
香港會計師公會

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Hong Kong Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (HKAS 21) is set out in paragraphs 1-62 and Appendices A-B. All the paragraphs have equal authority. HKAS 21 should be read in the context of its objective and the Basis for Conclusions, the *Preface to Hong Kong Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1 Hong Kong Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (HKAS 21) should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged.

Reasons for issuing HKAS 21

IN2 The objectives of the HKICPA in issuing HKAS 21 were to reduce or eliminate alternatives, redundancies and conflicts within the HKFRSs, to deal with some convergence issues and to make other improvements.

IN3 For HKAS 21 the HKICPA's main objective was to provide additional guidance on the translation method and on determining the functional and presentation currencies. The HKICPA did not reconsider the fundamental approach to accounting for the effects of changes in foreign exchange rates contained in HKAS 21.

The main features

IN4 The main features of HKAS 21 are described below.

Scope

IN5 The Standard excludes from its scope foreign currency derivatives that are within the scope of HKFRS 9 *Financial Instruments.* Similarly, the material on hedge accounting has been moved to HKAS 39 *Financial Instruments: Recognition and Measurement.*[1]

Definitions

IN6 Two notions are used:

- functional currency, ie the currency of the primary economic environment in which the entity operates.
- 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.

IN8 [Not used]

IN9 [Not used]

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

IN10 [Not used]

[1] In December 2013 the HKICPA replaced the hedge accounting requirements in HKAS 39 and relocated them to HKFRS 9.

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

IN11 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 in accordance with HKFRS 10 *Consolidated Financial Statements* or a parent, an investor with joint control of, or significant influence over, an investee preparing separate financial statements in accordance with HKAS 27 *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 presenting profit or loss and other comprehensive income 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 [Not used]

IN17 Entities must disclose when there has been a change in functional currency, and the reasons for the change.

Hong Kong 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 HKFRS 9 *Financial Instruments*;

(b) 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

(c) in translating an entity's results and financial position into a presentation currency.

4 HKFRS 9 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 HKFRS 9 (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. HKFRS 9 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 Hong Kong Financial Reporting Standards (HKFRSs). 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 HKAS 7 *Statement of Cash Flows*).

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.**

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

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 price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See HKFRS 13** ***Fair Value Measurement*****.)**

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

Foreign operation **is an entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.**

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

Exchangeable (paragraphs A2–A10)

8A An entity assesses whether a currency is exchangeable into another currency:

(a) at a measurement date; and

(b) for a specified purpose.

8B If an entity is able to obtain no more than an insignificant amount of the other currency at the measurement date for the specified purpose, the currency is not exchangeable into the other currency.

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 arrangement):

(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 HKAS 29 *Financial Reporting in Hyperinflationary Economies*. An entity cannot avoid restatement in accordance with HKAS 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; lease liabilities; 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; goodwill; intangible assets; inventories; property, plant and equipment; right-of-use assets; 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 (eg 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 arrangements. 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 HKAS 27 *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.

Estimating the spot exchange rate when a currency is not exchangeable (paragraphs A11–A17)

19A An entity shall estimate the spot exchange rate at a measurement date when a currency is not exchangeable into another currency (as described in paragraphs 8, 8A–8B and A2–A10) at that date. An entity's objective in estimating the spot exchange rate is to reflect the rate at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic conditions.

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 HKFRSs. 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 the ends of subsequent reporting periods

23 At the end of each reporting period:

(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 measured.

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 HKAS 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 HKAS 2 *Inventories.* Similarly, in accordance with HKAS 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 (ie 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 (eg the closing rate at the end of the reporting period).

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.

Recognition of exchange differences

27 As noted in paragraphs 3(a) and 5, HKFRS 9 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, HKFRS 9 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge are recognised initially in other comprehensive income 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 in other comprehensive income, any exchange component of that gain or loss shall be

recognised in other comprehensive income. 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 HKFRSs require some gains and losses to be recognised in other comprehensive income. For example, HKAS 16 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognised in other comprehensive income. 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 other comprehensive income.

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 (eg consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in other comprehensive income and reclassified from equity to 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 recognised in other comprehensive income in the financial statements that include the foreign operation and the reporting entity (ie financial statements in which the foreign operation is 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 recognised in other comprehensive income in accordance with paragraphs 32 and 39(c) are not reclassified from equity to 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 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 presenting profit or loss and other 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.

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.

(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. The cumulative amount of the exchange differences is presented in a separate component of equity until disposal of the foreign operation. 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 non-controlling interests are allocated to, and recognised as part of, non-controlling interests in the consolidated statement of financial position.

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 (ie assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent statement of financial position, 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 (ie 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 HKAS 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 HKAS 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 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 HKFRS 10 *Consolidated Financial Statements*). 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 is recognised in profit or loss or, if it arises from the circumstances described in paragraph 32, it is recognised in other comprehensive income and accumulated in a separate component of 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, HKFRS 10 allows the use of a different 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 end of the reporting period of the foreign operation. Adjustments are made for significant changes in exchange rates up to the end of the reporting period of the reporting entity in accordance with HKFRS 10. The same approach is used in applying the equity method to associates and joint ventures in accordance with HKAS 28 (as amended in 2011).

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 or partial disposal of a foreign operation

48 On the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation, recognised 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 recognised (see HKAS 1 *Presentation of Financial Statements* (as revised in 2007)).

48A In addition to the disposal of an entity's entire interest in a foreign operation, the following partial disposals are accounted for as disposals:

(a) when the partial disposal involves the loss of control of a subsidiary that includes a foreign operation, regardless of whether the entity retains a non-controlling interest in its former subsidiary after the partial disposal; and

(b) when the retained interest after the partial disposal of an interest in a joint arrangement or a partial disposal of an interest in an associate that includes a foreign operation is a financial asset that includes a foreign operation.

48B On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation that have been attributed to the non-controlling interests shall be derecognised, but shall not be reclassified to profit or loss.

48C On the partial disposal of a subsidiary that includes a foreign operation, the entity shall re-attribute the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income to the non-controlling interests in that foreign operation. In any other partial disposal of a foreign operation the entity shall reclassify to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income.

48D A partial disposal of an entity's interest in a foreign operation is any reduction in an entity's ownership interest in a foreign operation, except those reductions in paragraph 48A that are accounted for as disposals.

49 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. A write-down of the carrying amount of a foreign operation, either because of its own losses or because of an impairment recognised by the investor, does not constitute a partial disposal. Accordingly, no part of the foreign exchange gain or loss recognised in other comprehensive income is reclassified to 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. HKAS 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 HKFRS 9; and**

(b) **net exchange differences recognised 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.**

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 HKFRSs only if they comply with all the requirements of HKFRSs 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 HKFRSs 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:**

(a) **clearly identify the information as supplementary information to distinguish it from the information that complies with HKFRSs;**

(b) **disclose the currency in which the supplementary information is displayed; and**

(c) **disclose the entity's functional currency and the method of translation used to determine the supplementary information.**

57A When an entity estimates a spot exchange rate because a currency is not exchangeable into another currency (see paragraph 19A), the entity shall disclose information that enables users of its financial statements to understand how the currency not being exchangeable into the other currency affects, or is expected to affect, the entity's financial performance, financial position and cash flows. To achieve this objective, an entity shall disclose information about:

(a) the nature and financial effects of the currency not being exchangeable into the other currency;

(b) the spot exchange rate(s) used;

(c) the estimation process; and

(d) the risks to which the entity is exposed because of the currency not being exchangeable into the other currency.

57B Paragraphs A18–A20 specify how an entity applies paragraph 57A.

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 HKAS 21), issued in January 2006, 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 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 HKAS 8 Acco*unting Policies, Changes in Accounting Estimates and Errors*.

60a If an entity decides to apply this Standard for an earlier period, it is not required to apply all the HKASs with the effective date for that same period. However, it is required to apply the amendments set out in Appendix B on amendments to other pronouncements for that earlier period.

60A HKAS 1 (as revised in 2007) amended the terminology used throughout HKFRSs. In addition it amended paragraphs 27, 30–33, 37, 39, 41, 45, 48 and 52. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies HKAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.

60B HKAS 27 (as amended in 2008) added paragraphs 48A–48D and amended paragraph 49. An entity shall apply those amendments prospectively for annual periods beginning on or after 1 July 2009. If an entity applies HKAS 27 (amended 2008) for an earlier period, the amendments shall be applied for that earlier period.

60C [Deleted]

60D Paragraph 60B was amended by *Improvements to HKFRSs* issued in May 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted.

60E [Deleted]

60F HKFRS 10 and HKFRS 11 *Joint Arrangements*, issued in June 2011, amended paragraphs 3(b), 8, 11, 18, 19, 33, 44-46 and 48A. An entity shall apply those amendments when it applies HKFRS 10 and HKFRS 11.

60G HKFRS 13, issued in June 2011, amended the definition of fair value in paragraph 8 and amended paragraph 23. An entity shall apply those amendments when it applies HKFRS 13.

60H *Presentation of items of Other Comprehensive Income* (Amendments to HKAS 1), issued in July 2011, amended paragraph 39. An entity shall apply that amendment when it applies HKAS 1 as amended in July 2011.

60I [Deleted]

60J HKFRS 9, as issued in September 2014, amended paragraphs 3, 4, 5, 27, and 52 and deleted paragraphs 60C, 60E and 60I. An entity shall apply those amendments when it applies HKFRS 9.

60K HKFRS 16 *Leases*, issued in May 2016, amended paragraph 16. An entity shall apply that amendment when it applies HKFRS 16.

60L *Lack of Exchangeability*, issued in September 2023, amended paragraphs 8 and 26, and added paragraphs 8A–8B, 19A, 57A–57B and Appendix A. An entity shall apply those amendments for annual reporting periods beginning on or after 1 January 2025. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact. The date of initial application is the beginning of the annual reporting period in which an entity first applies those amendments.

60M In applying *Lack of Exchangeability*, an entity shall not restate comparative information. Instead:

(a) when the entity reports foreign currency transactions in its functional currency, and, at the date of initial application, concludes that its functional currency is not exchangeable into the foreign currency or, if applicable, concludes that the foreign currency is not exchangeable into its functional currency, the entity shall, at the date of initial application:

   (i) translate affected foreign currency monetary items, and non-monetary items measured at fair value in a foreign currency, using the estimated spot exchange rate at that date; and

   (ii) recognise any effect of initially applying the amendments as an adjustment to the opening balance of retained earnings.

(b) when the entity uses a presentation currency other than its functional currency, or translates the results and financial position of a foreign operation, and, at the date of initial application, concludes that its functional currency (or the foreign operation's functional currency) is not exchangeable into its presentation currency or, if applicable, concludes that its presentation currency is not exchangeable into its functional currency (or the foreign operation's functional currency), the entity shall, at the date of initial application:

(i) translate affected assets and liabilities using the estimated spot exchange rate at that date;

(ii) translate affected equity items using the estimated spot exchange rate at that date if the entity's functional currency is hyperinflationary; and

(iii) recognise any effect of initially applying the amendments as an adjustment to the cumulative amount of translation differences—accumulated in a separate component of equity.

Withdrawal of other pronouncements

61 This Standard supersedes SSAP 11 *Foreign Currency Translation* (revised in 2001).

62 [Not used]

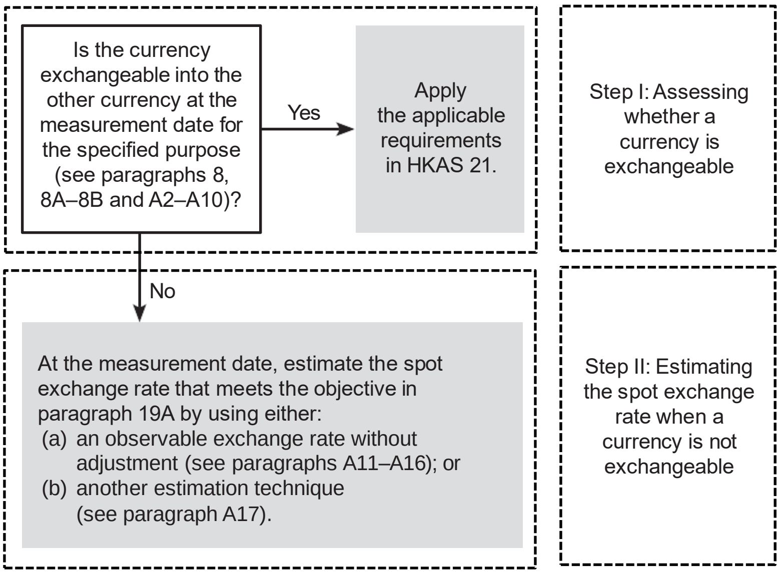
Appendix A

Application guidance

This appendix is an integral part of the Standard.

Exchangeability

A1 The purpose of the following diagram is to help entities assess whether a currency is exchangeable and estimate the spot exchange rate when a currency is not exchangeable.



Step I: Assessing whether a currency is exchangeable (paragraphs 8 and 8A–8B)

A2 Paragraphs A3–A10 set out application guidance to help an entity assess whether a currency is exchangeable into another currency. An entity might determine that a currency is not exchangeable into another currency, even though that other currency might be exchangeable in the other direction. For example, an entity might determine that currency PC is not exchangeable into currency LC, even though currency LC is exchangeable into currency PC.

Time frame

A3 Paragraph 8 defines a spot exchange rate as the exchange rate for immediate delivery. However, an exchange transaction might not always complete instantaneously because of legal or regulatory requirements, or for practical reasons such as public holidays. A normal administrative delay in obtaining the other currency does not preclude a currency from being exchangeable into that other currency. What constitutes a normal administrative delay depends on facts and circumstances.

Ability to obtain the other currency

A4 In assessing whether a currency is exchangeable into another currency, an entity shall consider its ability to obtain the other currency, rather than its intention or decision to do so. Subject to the other requirements in paragraphs A2–A10, a currency is exchangeable into another currency if an entity is able to obtain the other currency—either directly or indirectly—even if it intends or decides not to do so. For example, subject to the other requirements in paragraphs A2–A10, regardless of whether the entity intends or decides to obtain PC, currency LC is exchangeable into currency PC if an entity is able to either exchange LC for PC, or exchange LC for another currency (FC) and then exchange FC for PC.

Markets or exchange mechanisms

A5 In assessing whether a currency is exchangeable into another currency, an entity shall consider only markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations. Enforceability is a matter of law. Whether an exchange transaction in a market or exchange mechanism would create enforceable rights and obligations depends on facts and circumstances.

Purpose of obtaining the other currency

A6 Different exchange rates might be available for different uses of a currency. For example, a jurisdiction facing pressure on its balance of payments might wish to deter capital remittances (such as dividend payments) to other jurisdictions but encourage imports of specific goods from those jurisdictions. In such circumstances, the relevant authorities might:

(a) set a preferential exchange rate for imports of those goods and a ‘penalty’ exchange rate for capital remittances to other jurisdictions, thus resulting in different exchange rates applying to different exchange transactions; or

(b) make the other currency available only to pay for imports of those goods and not for capital remittances to other jurisdictions.

A7 Accordingly, whether a currency is exchangeable into another currency could depend on the purpose for which the entity obtains (or hypothetically might need to obtain) the other currency. In assessing exchangeability:

(a) when an entity reports foreign currency transactions in its functional currency (see paragraphs 20–37), the entity shall assume its purpose in obtaining the other currency is to realise or settle individual foreign currency transactions, assets or liabilities.

(b) when an entity uses a presentation currency other than its functional currency (see paragraphs 38–43), the entity shall assume its purpose in obtaining the other currency is to realise or settle its net assets or net liabilities.

(c) when an entity translates the results and financial position of a foreign operation into the presentation currency (see paragraphs 44–47), the entity shall assume its purpose in obtaining the other currency is to realise or settle its net investment in the foreign operation.

A8 An entity's net assets or net investment in a foreign operation might be realised by, for example:

(a) the distribution of a financial return to the entity's owners;

(b) the receipt of a financial return from the entity's foreign operation; or

(c) the recovery of the investment by the entity or the entity's owners, such as through disposal of the investment.

A9 An entity shall assess whether a currency is exchangeable into another currency separately for each purpose specified in paragraph A7. For example, an entity shall assess exchangeability for the purpose of reporting foreign currency transactions in its functional currency (see paragraph A7(a)) separately from exchangeability for the purpose of translating the results and financial position of a foreign operation (see paragraph A7(c)).

Ability to obtain only limited amounts of the other currency

A10 A currency is not exchangeable into another currency if, for a purpose specified in paragraph A7, an entity is able to obtain no more than an insignificant amount of the other currency. An entity shall assess the significance of the amount of the other currency it is able to obtain for a specified purpose by comparing that amount with the total amount of the other currency required for that purpose. For example, an entity with a functional currency of LC has liabilities denominated in currency FC. The entity assesses whether the total amount of FC it can obtain for the purpose of settling those liabilities is no more than an insignificant amount compared with the aggregated amount (the sum) of its liability balances denominated in FC.

Step II: Estimating the spot exchange rate when a currency is not exchangeable (paragraph 19A)

A11 This Standard does not specify how an entity estimates the spot exchange rate to meet the objective in paragraph 19A. An entity can use an observable exchange rate without adjustment (see paragraphs A12–A16) or another estimation technique (see paragraph A17).

Using an observable exchange rate without adjustment

A12 In estimating the spot exchange rate as required by paragraph 19A, an entity may use an observable exchange rate without adjustment if that observable exchange rate meets the objective in paragraph 19A. Examples of an observable exchange rate include:

(a) a spot exchange rate for a purpose other than that for which an entity assesses exchangeability (see paragraphs A13–A14); and

(b) the first exchange rate at which an entity is able to obtain the other currency for the specified purpose after exchangeability of the currency is restored (first subsequent exchange rate) (see paragraphs A15–A16).

Using an observable exchange rate for another purpose

A13 A currency that is not exchangeable into another currency for one purpose might be exchangeable into that currency for another purpose. For example, an entity might be able to obtain a currency to import specific goods but not to pay dividends. In such situations, the entity might conclude that an observable exchange rate for another purpose meets the objective in paragraph 19A. If the rate meets the objective in paragraph 19A, an entity may use that rate as the estimated spot exchange rate.

A14 In assessing whether such an observable exchange rate meets the objective in paragraph 19A, an entity shall consider, among other factors:

(a) *whether several observable exchange rates exist*—the existence of more than one observable exchange rate might indicate that exchange rates are set to encourage, or deter, entities from obtaining the other currency for particular purposes. These observable exchange rates might include an 'incentive' or 'penalty' and therefore might not reflect the prevailing economic conditions.

(b) *the purpose for which the currency is exchangeable*—if an entity is able to obtain the other currency only for limited purposes (such as to import emergency supplies), the observable exchange rate might not reflect the prevailing economic conditions.

(c) *the nature of the exchange rate*—a free-floating observable exchange rate is more likely to reflect the prevailing economic conditions than an exchange rate set through regular interventions by the relevant authorities.

(d) *the frequency with which exchange rates are updated*—an observable exchange rate unchanged over time is less likely to reflect the prevailing economic conditions than an observable exchange rate that is updated on a daily basis (or even more frequently).

Using the first subsequent exchange rate

A15 A currency that is not exchangeable into another currency at the measurement date for a specified purpose might subsequently become exchangeable into that currency for that purpose. In such situations, an entity might conclude that the first subsequent exchange rate meets the objective in paragraph 19A. If the rate meets the objective in paragraph 19A, an entity may use that rate as the estimated spot exchange rate.

A16 In assessing whether the first subsequent exchange rate meets the objective in paragraph 19A, an entity shall consider, among other factors:

(a) *the time between the measurement date and the date at which exchangeability is restored*—the shorter this period, the more likely the first subsequent exchange rate will reflect the prevailing economic conditions.

(b) *inflation rates*—when an economy is subject to high inflation, including when an economy is hyperinflationary (as specified in HKAS 29 *Financial Reporting in Hyperinflationary Economies*), prices often change quickly, perhaps several times a day. Accordingly, the first subsequent exchange rate for a currency of such an economy might not reflect the prevailing economic conditions.

Using another estimation technique

A17 An entity using another estimation technique may use any observable exchange rate—including rates from exchange transactions in markets or exchange mechanisms that do not create enforceable rights and obligations—and adjust that rate, as necessary, to meet the objective in paragraph 19A.

Disclosure when a currency is not exchangeable

A18 An entity shall consider how much detail is necessary to satisfy the disclosure objective in paragraph 57A. An entity shall disclose the information specified in paragraphs A19–A20 and any additional information necessary to meet the disclosure objective in paragraph 57A.

A19 In applying paragraph 57A, an entity shall disclose:

(a) the currency and a description of the restrictions that result in that currency not being exchangeable into the other currency;

(b) a description of affected transactions;

(c) the carrying amount of affected assets and liabilities;

(d) the spot exchange rates used and whether those rates are:

(i) observable exchange rates without adjustment (see paragraphs A12–A16); or

(ii) spot exchange rates estimated using another estimation technique (see paragraph A17);

(e) a description of any estimation technique the entity has used, and qualitative and quantitative information about the inputs and assumptions used in that estimation technique; and

(f) qualitative information about each type of risk to which the entity is exposed because the currency is not exchangeable into the other currency, and the nature and carrying amount of assets and liabilities exposed to each type of risk.

A20 When a foreign operation's functional currency is not exchangeable into the presentation currency or, if applicable, the presentation currency is not exchangeable into a foreign operation's functional currency, an entity shall also disclose:

(a) the name of the foreign operation; whether the foreign operation is a subsidiary, joint operation, joint venture, associate or branch; and its principal place of business;

(b) summarised financial information about the foreign operation; and

(c) the nature and terms of any contractual arrangements that could require the entity to provide financial support to the foreign operation, including events or circumstances that could expose the entity to a loss.

Appendix B

Amendments to other pronouncements

The amendments in this appendix shall be applied for annual periods beginning on or after 1 January 2005. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

* * *

The amendments contained in this appendix when this Standard was issued have been incorporated into the relevant Standards.

Basis for Conclusions on IAS 21 *The Effects of Changes in Foreign Exchange Rates*

HKAS 21 is based on IAS 21 *The Effects of Changes in Foreign Exchange Rates*. In approving HKAS 21, the Council of the Hong Kong Institute of Certified Public Accountants considered and agreed with the IASB's Basis for Conclusions on IAS 21 (as revised 2003). Accordingly, there are no significant differences between HKAS 21 and IAS 21. The IASB's Basis for Conclusions is reproduced below. The paragraph numbers of IAS 21 referred to below generally correspond with those in HKAS 21.

This Basis for Conclusions accompanies, but is not part of, IAS 21.

Paragraph BC1 was amended and paragraphs BC25A–BC25F were added in relation to the amendment to IAS 21 issued in December 2005.

Paragraph BC41–BC65 were added by Lack of Exchangeability (Amendments to IAS 21) issued in August 2023.

In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements *(as revised in 2007).*

Introduction

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 21 *The Effects of Changes in Foreign Exchange Rates* in 2003, and on the amendment to IAS 21 *Net Investment in a Foreign Operation* in December 2005. Individual Board members gave greater weight to some factors than to others.

BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 21. 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 Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within Standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in an Exposure Draft of *Improvements to International Accounting Standards*, with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the Exposure Draft.

BC3 Because the Board's intention was not to reconsider the fundamental approach to accounting for the effects of changes in foreign exchange rates established by IAS 21, this Basis for Conclusions does not discuss requirements in IAS 21 that the Board has not reconsidered.

Functional currency

BC4 The term 'reporting currency' was previously defined as 'the currency used in presenting the financial statements'. This definition comprises two separate notions (which were identified in SIC-19 *Reporting Currency–Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*):

- the measurement currency (the currency in which the entity measures the items in the financial statements); and
- the presentation currency (the currency in which the entity presents its financial statements).

The Board decided to revise the previous version of IAS 21 to incorporate the SIC-19 approach of separating these two notions. The Board also noted that the term ‘functional currency’ is more commonly used than ‘measurement currency’ and decided to adopt the more common term.

BC5 The Board noted a concern that the guidance in SIC-19 on determining a measurement currency could permit entities to choose one of several currencies, or to select an inappropriate currency. In particular, some believed that SIC-19 placed too much emphasis on the currency in which transactions are denominated and too little emphasis on the underlying economy that determines the pricing of those transactions. To meet these concerns, the Board defined functional currency as ‘the currency of the primary economic environment in which the entity operates’. The Board also provided guidance on how to determine the functional currency (see paragraphs 9-14 of the Standard). This guidance draws heavily on SIC-19 and equivalent guidance in US and other national standards, but also reflects the Board’s decision that some factors merit greater emphasis than others.

BC6 The Board also discussed whether a foreign operation that is integral to the reporting entity (as described in the previous version of IAS 21) could have a functional currency that is different from that of its ‘parent’.[1] The Board decided that the functional currencies will always be the same, because it would be contradictory for an integral foreign operation that ‘carries on business as if it were an extension of the reporting enterprise’s operations’[2] to operate in a primary economic environment different from its parent.

BC7 It follows that it is not necessary to translate the results and financial position of an integral foreign operation when incorporating them into the financial statements of the parent—they will already be measured in the parent’s functional currency. Furthermore, it is not necessary to distinguish between an integral foreign operation and a foreign entity. When a foreign operation’s functional currency is different from that of its parent, it is a foreign entity, and the translation method in paragraphs 38-49 of the Standard applies.

BC8 The Board also decided that the principles in the previous version of IAS 21 for distinguishing an integral foreign operation from a foreign entity are relevant in determining an operation’s functional currency. Hence it incorporated these principles into the Standard in that context.

BC9 The Board agreed that the indicators in paragraph 9 are the primary indicators for determining the functional currency and that paragraphs 10 and 11 are secondary. This is because the indicators in paragraphs 10 and 11 are not linked to the primary economic environment in which the entity operates but provide additional supporting evidence to determine an entity’s functional currency.

Presentation currency

BC10 A further issue is whether an entity should be permitted to present its financial statements in a currency (or currencies) other than its functional currency. Some believe it should not. They believe that the functional currency, being the currency of the primary economic environment in which the entity operates, most usefully portrays the economic effect of transactions and events on the entity. For a group that comprises operations with a number of functional currencies, they believe that the consolidated financial statements should be presented in the functional currency that management uses when controlling and monitoring the performance and financial position of the group. They also believe that allowing an entity to present its financial statements in more than one currency may confuse, rather than help, users of those financial

[1] The term ‘parent’ is used broadly in this context to mean an entity that has a branch, associate or joint venture, as well as one with a subsidiary.

[2] IAS 21 (revised 1993), paragraph 24

statements. Supporters of this view believe that any presentation in a currency other than that described above should be regarded as a 'convenience translation' that is outside the scope of IFRSs.

BC11 Others believe that the choice of presentation currency should be limited, for example, to the functional currency of one of the substantive entities within a group. However, such a restriction might be easily overcome—an entity that wished to present its financial statements in a different currency might establish a substantive, but relatively small operation with that functional currency.

BC12 Still others believe that, given the rising trend towards globalisation, entities should be permitted to present their financial statements in any currency. They note that most large groups do not have a single functional currency, but rather comprise operations with a number of functional currencies. For such entities, they believe it is not clear which currency should be the presentation currency, or why one currency is preferable to another. They also point out that management may not use a single currency when controlling and monitoring the performance and financial position of such a group. In addition, they note that in some jurisdictions, entities are required to present their financial statements in the local currency, even when this is not the functional currency.[3] Hence, if IFRSs required the financial statements to be presented in the functional currency, some entities would have to present two sets of financial statements: financial statements that comply with IFRSs presented in the functional currency and financial statements that comply with local regulations presented in a different currency.

BC13 The Board was persuaded by the arguments in the previous paragraph. Accordingly, it decided that entities should be permitted to present their financial statements in any currency (or currencies).

BC14 The Board also clarified that the Standard does not prohibit the entity from providing, as supplementary information, a 'convenience translation'. Such a 'convenience translation' may display financial statements (or selected portions of financial statements) in a currency other than the presentation currency, as a convenience to some users. The 'convenience translation' may be prepared using a translation method other than that required by the Standard. These types of 'convenience translations' should be clearly identified as supplementary information to distinguish them from information required by IFRSs and translated in accordance with the Standard.

Translation method

BC15 The Board debated which method should be used to translate financial statements from an entity's functional currency into a different presentation currency.

BC16 The Board agreed that the translation method should not have the effect of substituting another currency for the functional currency. Put another way, presenting the financial statements in a different currency should not change the way in which the underlying items are measured. Rather, the translation method should merely express the underlying amounts, as measured in the functional currency, in a different currency.

BC17 Given this, the Board considered two possible translation methods. The first is to translate all amounts (including comparatives) at the most recent closing rate. This method has several advantages: it is simple to apply; it does not generate any new gains and losses; and it does not change ratios such as return on assets. This method is supported by those who believe that the process of merely expressing amounts in a different currency should preserve the relationships among amounts as measured in the functional currency and, as such, should not lead to any new gains or losses.

3 This includes entities operating in another country and, for example, publishing financial statements to comply with a listing requirement of that country.

BC18 The second method considered by the Board is the one that the previous version of IAS 21 required for translating the financial statements of a foreign operation.[4] This method results in the same amounts in the presentation currency regardless of whether the financial statements of a foreign operation are:

(a) first translated into the functional currency of another group entity (eg the parent) and then into the presentation currency, or

(b) translated directly into the presentation currency.

BC19 This method avoids the need to decide the currency in which to express the financial statements of a multinational group before they are translated into the presentation currency. As noted above, many large groups do not have a single functional currency, but comprise operations with a number of functional currencies. For such entities it is not clear which functional currency should be chosen in which to express amounts before they are translated into the presentation currency, or why one currency is preferable to another. In addition, this method produces the same amounts in the presentation currency for a stand-alone entity as for an identical subsidiary of a parent whose functional currency is the presentation currency.

BC20 The Board decided to require the second method, ie that the financial statements of any entity (whether a stand-alone entity, a parent or an operation within a group) whose functional currency differs from the presentation currency used by the reporting entity are translated using the method set out in paragraphs 38-49 of the Standard.

BC21 With respect to translation of comparative amounts, the Board adopted the approach required by SIC-30 for:

(a) an entity whose functional currency is not the currency of the hyperinflationary economy (assets and liabilities in the comparative balance sheet are translated at the closing rate at the date of that balance sheet and income and expenses in the comparative income statement are translated at exchange rates at the dates of the transactions); and

(b) an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into the currency of a hyperinflationary economy (both balance sheet and income statement items are translated at the closing rate of the most recent balance sheet presented).

BC22 However, the Board decided not to adopt the SIC-30 approach for the translation of comparatives for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into a presentation currency of a non-hyperinflationary economy. The Board noted that in such a case, the SIC-30 approach requires restating the comparative amounts from those shown in last year's financial statements for both the effects of inflation and for changes in exchange rates. If exchange rates fully reflect differing price levels between the two economies to which they relate, the SIC-30 approach will result in the same amounts for the comparatives as were reported as current year amounts in the prior year financial statements. Furthermore, the Board noted that in the prior year, the relevant amounts had been already expressed in the non-hyperinflationary presentation currency, and there was no reason to change them. For these reasons the Board decided to require that all comparative amounts are those presented in the prior year financial statements (ie there is no adjustment for either subsequent changes in the price level or subsequent changes in exchange rates).

BC23 The Board decided to incorporate into the Standard most of the disclosure

[4] This is to translate balance sheet items at the closing rate and income and expense items at actual (or average) rates, except for an entity whose functional currency is that of a hyperinflationary economy.

requirements of SIC-30 *Reporting Currency–Translation from Measurement Currency to Presentation Currency* that apply when a different translation method 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 (see paragraph 57 of the Standard). These disclosures enable users to distinguish information prepared in accordance with IFRSs from information that may be useful to users but is not the subject of IFRSs, and also tell users how the latter information has been prepared.

Capitalisation of exchange differences

BC24 The previous version of IAS 21 allowed a limited choice of accounting for exchange differences that arise 'from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset'.[5] The benchmark treatment was to recognise such exchange differences in profit or loss. The allowed alternative was to recognise them as an asset.

BC25 The Board noted that the allowed alternative (of recognition as an asset) was not in accordance with the *Framework for the Preparation and Presentation of Financial Statements*[6] because exchange losses do not meet the definition of an asset. Moreover, recognition of exchange losses as an asset is neither allowed nor required by any liaison standard-setter, so its deletion would improve convergence. Finally, in many cases when the conditions for recognition as an asset are met, the asset would be restated in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies*. Thus, to the extent that an exchange loss reflects hyperinflation, this effect is taken into account by IAS 29. For all of these reasons, the Board removed the allowed alternative treatment and the related SIC Interpretation is superseded.

Net investment in a foreign operation

BC25A The principle in paragraph 32 is that exchange differences arising on a monetary item that is, in substance, part of the reporting entity's net investment in a foreign operation are initially recognised in a separate component of equity[7] in the consolidated financial statements of the reporting entity. Among the revisions to IAS 21 made in 2003 was the provision of guidance on this principle that required the monetary item to be denominated in the functional currency of either the reporting entity or the foreign operation. The previous version of IAS 21 did not include such guidance.

BC25B The requirements can be illustrated by the following example. Parent P owns 100 per cent of Subsidiary S. Parent P has a functional currency of UK sterling. Subsidiary S has a functional currency of Mexican pesos. Parent P grants a loan of 100 US dollars to Subsidiary S, for which settlement is neither planned nor likely to occur in the foreseeable future. IAS 21 (as revised in 2003) requires the exchange differences arising on the loan to be recognised in profit or loss in the consolidated financial statements of Parent P, whereas those differences would be recognised initially in equity in the consolidated financial statements of Parent P, if the loan were to be denominated in sterling or Mexican pesos.

BC25C After the revised IAS 21 was issued in 2003, constituents raised the following concerns:

(a) It is common practice for a monetary item that forms part of an entity's investment in a foreign operation to be denominated in a currency that is not the functional currency of either the reporting entity or the foreign operation. An example is a monetary item denominated in a currency that is more readily

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5 IAS 21 (revised 1993), paragraph 21.

6 The reference is to the IASC's *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Standard was revised.

7 As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such difference are recognised in other comprehensive income.

convertible than the local domestic currency of the foreign operation.

(b) An investment in a foreign operation denominated in a currency that is not the functional currency of the reporting entity or the foreign operation does not expose the group to a greater foreign currency exchange difference than arises when the investment is denominated in the functional currency of the reporting entity or the foreign operation. It simply results in exchange differences arising in the foreign operation's individual financial statements and the reporting entity's separate financial statements.

(c) It is not clear whether the term 'reporting entity' in paragraph 32 should be interpreted as the single entity or the group comprising a parent and all its subsidiaries. As a result, constituents questioned whether the monetary item must be transacted between the foreign operation and the reporting entity, or whether it could be transacted between the foreign operation and any member of the consolidated group, ie the reporting entity or any of its subsidiaries.

BC25D The Board noted that the nature of the monetary item referred to in paragraph 15 is similar to an equity investment in a foreign operation, ie settlement of the monetary item is neither planned nor likely to occur in the foreseeable future. Therefore, the principle in paragraph 32 to recognise exchange differences arising on a monetary item initially in a separate component of equity effectively results in the monetary item being accounted for in the same way as an equity investment in the foreign operation when consolidated financial statements are prepared. The Board concluded that the accounting treatment in the consolidated financial statements should not be dependent on the currency in which the monetary item is denominated, nor on which entity within the group conducts the transaction with the foreign operation.

BC25E Accordingly, in 2005 the Board decided to amend IAS 21. The amendment requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised initially in a separate component of equity in the consolidated financial statements. This requirement applies irrespective of the currency of the monetary item and of whether the monetary item results from a transaction with the reporting entity or any of its subsidiaries.

BC25F The Board also proposed amending IAS 21 to clarify that an investment in a foreign operation made by an associate of the reporting entity is not part of the reporting entity's net investment in that foreign operation. Respondents to the exposure draft disagreed with this proposal. Many respondents said that the proposed amendment added a detailed rule that was not required because the principle in paragraph 15 was clear. In redeliberations, the Board agreed with those comments and decided not to proceed with that proposed amendment.

Goodwill and fair value adjustments

BC26 The previous version of IAS 21 allowed a choice of translating goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity at (a) the closing rate or (b) the historical transaction rate.

BC27 The Board agreed that, conceptually, the correct treatment depends on whether goodwill and fair value adjustments are part of:

(a) the assets and liabilities of the acquired entity (which would imply translating them at the closing rate); or

(b) the assets and liabilities of the parent (which would imply translating them at the historical rate).

BC28 The Board agreed that fair value adjustments clearly relate to the identifiable assets and liabilities of the acquired entity and should therefore be translated at the closing rate.

BC29 Goodwill is more complex, partly because it is measured as a residual. In addition, the Board noted that difficult issues can arise when the acquired entity comprises businesses that have different functional currencies (eg if the acquired entity is a multinational group). The Board discussed how to assess any resulting goodwill for impairment and, in particular, whether the goodwill would need to be 'pushed down' to the level of each different functional currency or could be accounted for and assessed at a higher level.

BC30 One view is that when the parent acquires a multinational operation comprising businesses with many different functional currencies, any goodwill may be treated as an asset of the parent/acquirer and tested for impairment at a consolidated level. Those who support this view believe that, in economic terms, the goodwill is an asset of the parent because it is part of the acquisition price paid by the parent. Thus, they believe, it would be incorrect to allocate the goodwill to the many acquired businesses and translate it into their various functional currencies. Rather, the goodwill, being treated as an asset of the parent, is not exposed to foreign currency risks, and translation differences associated with it should not be recognised. In addition, they believe that such goodwill should be tested for impairment at a consolidated level. Under this view, allocating or 'pushing down' the goodwill to a lower level, such as each different functional currency within the acquired foreign operation, would not serve any purpose.

BC31 Others take a different view. They believe that the goodwill is part of the parent's net investment in the acquired entity. In their view, goodwill should be treated no differently from other assets of the acquired entity, in particular intangible assets, because a significant part of the goodwill is likely to comprise intangible assets that do not qualify for separate recognition. They also note that goodwill arises only because of the investment in the foreign entity and has no existence apart from that entity. Lastly, they point out that 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.

BC32 The Board was persuaded by the reasons set out in the preceding paragraph and decided that goodwill is treated as an asset of the foreign operation and translated at the closing rate. Consequently, goodwill should be 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 IAS 36 *Impairment of Assets* to determine the level at which goodwill is tested for impairment.

Disposal or partial disposal of a foreign operation[8]

BC33 In the second phase of the business combinations project the Board decided that the loss of control, significant influence or joint control of an entity is accounted for as a disposal for the purposes of IAS 21. Accordingly, a former parent accounts for the loss of control over a subsidiary as a disposal of the subsidiary, even if the former subsidiary becomes an associate or jointly controlled entity[9] of the former parent. Similarly an investor accounts for the loss of significant influence over an associate or the loss of joint control over a jointly controlled entity as a disposal. The Board decided that the change in the nature of the investment is a significant economic event.

[8] This heading and paragraphs BC33 and BC34 were added as a consequence of amendments to IAS 27 *Consolidated and Separate Financial Statements* made as part of the second phase of the business combinations project in 2008. The consolidation requirements in IAS 27 were superseded by IRFS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements did not change.

[9] 'Jointly controlled entities' were defined in IAS 31 *Interests in Joint Ventures.* IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31 and changed the terminology.

BC34 The Board also decided in the second phase of the business combinations project that:

(a) changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners);

(b) if a parent loses control of a subsidiary, the parent reclassifies from equity to profit or loss (as a reclassification adjustment) the parent's share of the exchange differences recognised in other comprehensive income relating to a foreign operation in that subsidiary; and

(c) if an investor loses significant influence over an associate or loses joint control over a jointly controlled entity, the investor reclassifies from equity to profit or loss (as a reclassification adjustment) the exchange differences recognised in other comprehensive income relating to a foreign operation in that associate or jointly controlled entity.

The amendments in paragraphs 48A–49 of the Standard reflect those decisions for the disposal or partial disposal of a foreign operation.

BC35 As part of *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements*), issued in May 2008, the Board amended IAS 27 to remove the definition of the 'cost method'. The cost method required an entity to recognise distributions as income only if they came from post-acquisition retained earnings. Distributions received in excess of such profits were regarded as a recovery of the investment and were recognised as a reduction of its cost. Consequently, the Board amended paragraph 49 to remove the reference to pre-acquisition profits and to clarify that a dividend accounted for in accordance with paragraph 38A of IAS 27 cannot be a disposal or partial disposal of a net investment in IAS 21.[10]

Disposal or partial disposal of a foreign operation (amendment 2011)

BC36 During its redeliberation of the exposure draft ED 9 *Joint Arrangements*, the Board reconsidered whether its decision in the second phase of the business combinations project to characterise loss of joint control or loss of significant influence as a significant economic event (ie in the same way that loss of control is characterised as a significant economic event) was appropriate. If it were, the Board thought that the entity should be required to recalibrate the accounting as required by IFRS 10 *Consolidated Financial Statements*. However, the Board concluded that, although significant, the events are fundamentally different. In the case of loss of control, the cessation of the parent-subsidiary relationship results in the derecognition of assets and liabilities because the composition of the group changes. If joint control or significant influence is lost the composition of the group is unaffected.

BC37 The Board also noted that retaining the characterisation of significant economic event in the case of loss of joint control or significant influence when the retained interest is a financial asset is unnecessary. IFRS 9 already requires that in such cases the retained interest (ie a financial asset) must be measured at fair value.

BC38 In the case of loss of joint control when significant influence is maintained, the Board acknowledged that the investor-investee relationship changes and, consequently, so does the nature of the investment. However, in this instance, both investments (ie the joint venture and the associate) continue to be measured using the equity method.

[10] The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements for dividends were not changed.

Considering that there is neither a change in the group boundaries nor a change in the measurement requirements, the Board concluded that losing joint control and retaining significant influence is not an event that warrants remeasurement of the retained interest at fair value.

BC39 Consequently, the Board removed all descriptions that characterise loss of joint control or significant influence as a significant economic event as introduced in the second phase of the Board's project on business combinations.

BC40 The Board also decided to align the conclusions reached on the loss of joint control when significant influence is maintained with the requirements in IAS 21 so that the change from joint control to significant influence is treated as a 'partial' disposal rather than deemed to be an 'entire' disposal. As a consequence, the Board concluded that when an entity loses joint control of a joint arrangement that includes a foreign operation but retains significant influence, an entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income relating to a foreign operation in that joint arrangement.

Lack of Exchangeability

Background to the August 2023 amendments

BC41 In August 2023 the IASB issued *Lack of Exchangeability* and amended the Standard to improve the usefulness of information provided to users of financial statements. The amendments require entities to apply a consistent approach to determining whether a currency is exchangeable into another currency and the spot exchange rate to use when it is not. The IASB had been informed of diverse views among stakeholders on how to determine whether a currency is exchangeable into another currency and the exchange rate to use when it is not. Although circumstances in which a currency is not exchangeable into another currency might arise relatively infrequently, when they do arise, economic conditions can deteriorate rapidly. In those circumstances, the diverse views on the application of the Standard could have led to material differences in affected entities' financial statements. In developing the amendments, the IASB considered input from the IFRS Interpretations Committee and feedback from stakeholders on the IASB's April 2021 Exposure Draft *Lack of Exchangeability*.

Assessing whether a currency is exchangeable

BC42 Many factors influence the exchangeability of one currency into another currency. To make the definition of 'exchangeable' operational and to help entities apply that definition consistently, the Standard specifies when an entity is able to exchange a currency for another currency. In developing the definition and related application guidance, the IASB discussed the following questions:

(a) what time frame for obtaining the other currency does an entity consider (see paragraphs BC43–BC44)?

(b) what if an entity is able to obtain the other currency, but does not intend to do so (see paragraph BC45)?

(c) which markets or exchange mechanisms for obtaining the other currency does an entity consider (see paragraph BC46)?

(d) what is the purpose for which an entity obtains the other currency (see paragraphs BC47–BC50)?

(e) what if an entity is able to obtain only limited amounts of the other currency (see paragraphs BC51–BC52)?

Time frame

BC43 The IASB concluded that a normal administrative delay in obtaining the other currency:

(a) does not contradict the notion of 'immediate delivery' in the definition of a spot exchange rate in paragraph 8 of the Standard. In the IASB's view, the notion of 'immediate delivery' incorporates a short period of time to meet administrative, legal or regulatory requirements in exchanging currencies.

(b) does not preclude a currency from being exchangeable into that other currency. In the IASB's view, acknowledging the existence of normal administrative delays in currency exchanges improves the operability of the requirements. If an entity cannot consider a normal administrative delay in its assessment of the time frame to exchange one currency for another, the entity might inappropriately conclude that a currency is not exchangeable into another currency.

BC44 The IASB decided not to develop application guidance on what constitutes a 'normal administrative delay'—this assessment would depend on facts and circumstances.

Ability to obtain the other currency

BC45 The IASB decided that assessing whether a currency is exchangeable into another currency depends on an entity's ability to obtain the other currency and not on its intention or decision to do so. For example, a currency can be exchangeable into another currency for the purpose of realising an entity's net investment in a foreign operation even if the entity has no intention of entering into a transaction that would result in realising that net investment. This requirement is consistent with other requirements in the Standard—for example, the requirement to use a spot exchange rate when translating amounts into another currency, regardless of an entity's intention or decision to enter into a transaction at that spot exchange rate.

Markets or exchange mechanisms

BC46 The IASB observed that the nature and type of markets or exchange mechanisms can vary between jurisdictions. The IASB discussed whether to require an entity to consider specified markets or exchange mechanisms (for example, government-administered exchange mechanisms) when assessing exchangeability. The IASB decided that, when assessing whether a currency is exchangeable into another currency, entities consider only markets or exchange mechanisms in which a transaction to exchange that currency into the other currency would create enforceable rights and obligations.

Purpose of obtaining the other currency

BC47 In many jurisdictions (particularly those in which exchange rates are free-floating), only one exchange rate exists between two currencies. In such jurisdictions, the purpose for which an entity intends to use the other currency would neither change the exchange rate nor affect the entity's ability to obtain that other currency. However, for some currencies, different exchange rates might apply for different uses, which could affect an entity's ability to obtain those currencies. The IASB therefore concluded that it is important for an entity to consider the purpose for which it obtains the other currency.

BC48 The IASB considered, separately, situations in which an entity:

(a) reports foreign currency transactions in its functional currency (see paragraph BC49); and

(b) uses a presentation currency other than its functional currency or translates the results and financial position of a foreign operation (see paragraph BC50).

BC49 Paragraphs 20–37 of the Standard specify requirements for reporting foreign currency transactions in the functional currency. These requirements apply to individual foreign currency transactions, and monetary and non-monetary items relating to such transactions. The IASB decided that, when reporting foreign currency transactions, an entity assesses a currency's exchangeability separately for each individual transaction, asset or liability—that is, an entity would assume the purpose of obtaining foreign currency is to realise or settle the individual foreign currency transaction, or an asset or liability related to that transaction. An entity would therefore assess whether it is able to obtain the other currency to realise or settle the transaction, or the asset or liability related to that transaction. Requiring entities to assess each individual transaction, asset or liability does not create a new assessment, because paragraph 26 of the Standard requires an entity to do so when several exchange rates are available.

BC50 Paragraphs 38–49 of the Standard specify requirements for the use of a presentation currency other than the functional currency and for translating the results and financial position of a foreign operation. These requirements apply to all assets and liabilities (that is, the net assets or net liabilities)—and not to individual assets or liabilities—of an entity or its foreign operation. The IASB therefore decided that, in these situations, an entity assesses exchangeability from the perspective of a transaction that would result in realising or settling its net assets or net liabilities (or net investment in the foreign operation). The IASB observed that:

(a) entities in some jurisdictions might experience a delay in remitting dividends, and such a delay would not necessarily result in an entity concluding that a currency is not exchangeable into the other currency; such a delay might reflect a normal administrative delay. Also, an entity concluding that a currency is not exchangeable into another currency does not automatically require the entity to use a complex estimation technique (see paragraph BC55).

(b) an entity considers its ability to realise its net assets (or net investment in a foreign operation) in a single transaction—and not over time—even though an entity might often be unable to realise its net assets in a single transaction. This consideration is consistent with other requirements in the Standard (see paragraph BC49). In accordance with paragraph A10 of the Standard, a currency would be exchangeable into another currency even if an entity is unable to obtain the entire amount—but is able to obtain more than an insignificant amount—of the other currency required to realise its net assets or net investment in a foreign operation (see paragraphs BC51–BC52).

Ability to obtain only limited amounts of the other currency

BC51 An entity might be able to obtain only limited amounts of the other currency. The IASB decided to specify that, in such circumstances, a currency is exchangeable into another currency when an entity is able to obtain more than an insignificant amount of that other currency. This approach is similar to the approach in IFRS 13 *Fair Value Measurement* when the volume or level of activity for an asset or liability has significantly decreased (see paragraphs B37–B42 of IFRS 13), in which case an entity may depart from using unadjusted observable prices. Similarly, when the activity in the market in which an entity obtains the other currency is so low that the entity is able to obtain no more than an insignificant amount of that other currency, the entity estimates the spot exchange rate applying paragraph 19A of the Standard—in which case the entity may depart from using the observable exchange rate.

BC52 In developing the requirements, the IASB considered the level at which an entity assesses the significance of the amount of the other currency it is able to obtain—for example, whether an entity performs this assessment for each transaction and balance separately, or on an aggregated basis. The IASB decided that an entity assesses the significance of the amount of the other currency it is able to obtain for a specified purpose using the aggregate method described in paragraph A10 of the Standard. Instead of requiring an entity to consider each transaction or balance separately, the aggregate method requires an entity to compare the amount of the other currency it is able to obtain with the aggregated amount (the sum) of the transactions or balances it needs to recover or settle.

Estimating the spot exchange rate when a currency is not exchangeable

BC53 The IASB decided that when one currency is not exchangeable into another currency at a measurement date, an entity estimates the spot exchange rate at that date. The objective in paragraph 19A of the Standard is for an entity to estimate the rate at which an orderly exchange transaction hypothetically would take place at the measurement date between market participants under prevailing economic conditions. This approach is similar to (although not the same as) an entity measuring an asset or liability at fair value by estimating the price at which an orderly transaction to sell the asset or transfer the liability hypothetically would take place at the measurement date.

BC54 The IASB decided not to provide any detailed requirements on how an entity estimates a spot exchange rate because:

(a) estimating a spot exchange rate can be complicated and depends on entity-specific and jurisdiction-specific facts and circumstances.

(b) the economic models an entity might use to estimate a spot exchange rate are varied. These models vary in complexity and in the economic factors they use as inputs (for example, inflation, interest rates, the balance of payments or a jurisdiction's productivity). The IASB decided not to prescribe one particular estimation technique or approach because that technique or approach would be unlikely to capture all relevant factors for all possible situations without being overly burdensome.

(c) the requirements for assessing exchangeability are expected to result in an entity estimating the spot exchange rate only in a narrow set of circumstances.

(d) the uncertainties inherent in estimating a spot exchange rate are similar to those that relate to other financial information based on estimates. An entity is required to disclose relevant information about the estimated spot exchange rate and the estimation technique (see paragraphs BC58–BC62).

(e) such an approach is consistent with the measurement requirements in other IFRS Accounting Standards. For example, IFRS 9 *Financial Instruments* does not specify a particular technique for the measurement of expected credit losses, but instead sets out an objective.

BC55 The IASB noted that when a currency is not exchangeable into another currency, an entity would not necessarily need to use a complex estimation technique. To reduce complexity, the IASB decided to:

(a) specify that an entity may use an observable exchange rate without adjustment as the estimated spot exchange rate, if that observable exchange rate meets the objective in paragraph 19A of the Standard (see paragraph A12 of the Standard).

(b) include two examples of observable exchange rates that an entity could consider and set out a non-exhaustive list of factors to help entities assess whether those observable exchange rates would meet the objective in paragraph 19A of the Standard (see paragraphs A13–A16 of the Standard).

(c) specify that an entity using another estimation technique could, for example, start with an observable exchange rate—including a rate from an exchange transaction in a market or exchange mechanism that does not create enforceable rights and obligations—and adjust that rate, as necessary, to estimate the spot exchange rate as required by paragraph 19A of the Standard (see paragraph A17 of the Standard).

Other considerations

BC56 The IASB decided not to specify a hierarchy of observable exchange rates to use in estimating a spot exchange rate because doing so might impose costs without providing more useful information. For example, a hierarchy of observable exchange rates would require an entity to look for, and successively consider, each exchange rate in the hierarchy, when it might be more cost-effective for the entity to use another estimation technique.

BC57 When an entity is able to obtain only limited amounts of the other currency, the IASB considered whether to permit or require the entity to use a blended exchange rate (that is, a weighted average exchange rate reflecting both the rate at which the entity could obtain the other currency for a portion of the transaction or balance and an estimated exchange rate for the remaining portion). The IASB decided not to permit or require the use of such a rate because:

(a) determining a blended exchange rate could be difficult for an entity, thereby increasing costs for preparers without providing significant additional benefits.

(b) in determining a blended exchange rate, an entity would use the observable spot exchange rate only for an insignificant portion of the transaction or balance, and the estimated spot exchange rate for the remaining portion. The entity would do so because, applying the requirements in paragraph A10 of the Standard, the entity would conclude that a currency is not exchangeable into the other currency only when the entity is able to obtain no more than an insignificant amount of the other currency. Therefore, in most cases, the IASB expected that a blended exchange rate will not differ significantly from the estimated spot exchange rate.

Disclosure

BC58 An entity's estimation of a spot exchange rate when a currency is not exchangeable into another currency could materially affect its financial statements. That estimation would also require the entity to make judgements and assumptions. In developing the requirements, the IASB was informed that users of financial statements are interested not only in the effect on an entity's financial statements of estimating the spot exchange rate, but also in understanding an entity's exposure to a currency that is not exchangeable into another currency. Users said information about the nature and financial effects of a currency not being exchangeable into another currency, the spot exchange rate used, the estimation process and the risks to which the entity is exposed would help their analyses. Accordingly, the applicable disclosure requirements in the Standard are designed to provide users with such information.

BC59 The IASB observed that some of the requirements in paragraphs A19–A20 of the Standard are similar to those in other IFRS Accounting Standards. An entity might already provide some of the information those paragraphs require when applying other Standards. For example, an entity might already provide:

(a) summarised financial information about a foreign operation, in accordance with paragraphs B10 or B12–B13 of IFRS 12 *Disclosure of Interests in Other Entities*;

(b) information about the methodology used to estimate the spot exchange rate, in accordance with paragraphs 125–133 of IAS 1 *Presentation of Financial Statements*; and

(c) some (or all) of the qualitative and quantitative information about the nature and extent of risks arising from a currency that is not exchangeable into another currency, in accordance with the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* and IFRS 12.

BC60 Nonetheless, the IASB concluded it would be helpful to include the requirements in paragraphs A19–A20 of the Standard. The IASB observed that an entity need not duplicate information required by the Standard if it has provided the information in its financial statements by applying other disclosure requirements.

BC61 The IASB concluded that it was unnecessary to include specific disclosure requirements regarding significant judgements made in assessing exchangeability. Paragraph 122 of IAS 1 already requires disclosure of such judgements to the extent they are part of the judgements an entity's management has made that have the most significant effect on the amounts recognised in the financial statements.

BC62 The IASB noted that, for an entity applying paragraph 57A of the Standard, disclosures are required when a currency is not exchangeable into another currency at the end of the reporting period and also when a currency is not exchangeable into another currency during part of the reporting period—even if that is no longer the case at the end of the reporting period.

Transition

Entities already applying IFRS Accounting Standards

BC63 The IASB developed the transition requirements in paragraphs 60L–60M of the Standard because it concluded that the expected benefits of requiring entities to apply the amendments retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, would not outweigh the costs. In particular:

(a) applying the amendments retrospectively would require an entity to assess exchangeability in prior periods and then estimate spot exchange rates for those prior periods. In many cases, retrospective application would be likely to require the use of hindsight and, even if possible without hindsight, would be costly.

(b) a currency not being exchangeable into another currency is generally accompanied by high inflation and other economic events that make trend information less useful for investors than in other situations. The IASB was informed that, when a currency is not exchangeable into another currency, users of financial statements are interested in understanding an entity's exposure at the reporting date to that currency. The IASB therefore concluded that an entity applies the amendments from the date of initial application without restating comparative information.

BC64 The IASB decided:

(a) to require an entity to translate items using the estimated spot exchange rate at the date of initial application if the related requirement in the Standard requires an entity to translate that item using the closing rate.

(b) not to permit an entity to retranslate other items, even though they might have been translated using a spot exchange rate that is not aligned with the amendments. The expected benefits of requiring an entity to identify those items and then estimate an appropriate exchange rate would not outweigh the costs.

(c) to require an entity to recognise any effect of initially applying the amendments as an adjustment to:

(i) the opening balance of retained earnings when the entity reports foreign currency transactions. For these transactions, an entity generally recognises exchange differences in profit or loss. Requiring entities to track separately any exchange differences recognised in other comprehensive income would introduce unnecessary complexity.

(ii) the cumulative amount of translation differences in equity when the entity uses a presentation currency other than its functional currency, or translates the results and financial position of a foreign operation. In these situations, an entity generally recognises exchange differences in other comprehensive income and accumulates those differences in a separate component of equity.

First-time adopters

BC65 The IASB concluded that a specific exemption from retrospective application of the amendments would be unnecessary for a first-time adopter because:

(a) IFRS 1 does not provide any exemption for a first-time adopter that reports foreign currency transactions in its financial statements. The entity therefore applies all the applicable requirements in IAS 21 retrospectively when reporting foreign currency transactions.

(b) paragraph D13 of IFRS 1 already allows a first-time adopter to deem the cumulative translation differences for all foreign operations to be zero at its date of transition to IFRS Accounting Standards.

Illustrative Examples

These examples accompany, but are not part of, IAS 21. They illustrate aspects of IAS 21 but are not intended to provide interpretative guidance.

Introduction

IE1 These examples illustrate how an entity might apply some of the requirements in IAS 21 in hypothetical situations based on the limited facts presented. Although some aspects of the examples might be present in actual fact patterns, fact patterns in the examples are simplified, and an entity would need to evaluate all relevant facts and circumstances when applying IAS 21. The examples do not illustrate all the requirements in IAS 21, nor do they create additional requirements.

Exchangeability

IE2 Examples 1–3 illustrate how an entity assesses whether a currency is exchangeable (Step I as set out in paragraphs 8, 8A–8B and A2–A10). Examples 4–5 illustrate how an entity estimates the spot exchange rate when a currency is not exchangeable (Step II as set out in paragraphs 19A and A11–A17). In all five examples:

(a) Entity X's functional and presentation currency is PC. Entity X prepares consolidated financial statements.

(b) Entity X has a subsidiary, Entity Y, that is a foreign operation. Entity Y's functional currency is LC, the currency of the jurisdiction in which Entity Y operates. The relevant authority administers the exchangeability of LC for other currencies.

Step I: Assessing whether a currency is exchangeable (paragraphs 8, 8A–8B and A2–A10)

Example 1—Time frame

IE3 The relevant authority in Entity Y's jurisdiction makes PC available to entities in exchange for LC only after completion of an administrative process. The authority requires entities wishing to obtain PC to explain how they intend to use PC when submitting a request for PC. In usual circumstances, an entity obtains PC after N days—that is, N days is the time the authority needs, under its administrative process, to perform checks and provide PC.

IE4 Entity X considers N days to be a normal administrative delay applying to a transaction to exchange LC for PC through this exchange mechanism. Subject to the other requirements in paragraphs A2–A10, Entity X considers LC to be exchangeable into PC if Entity X is able to obtain PC within N days of requesting it.

Example 2—Markets or exchange mechanisms

IE5 The relevant authority in Entity Y's jurisdiction is unable to meet demand for PC and temporarily stops making PC available through the exchange mechanism it administers. In the absence of this exchange mechanism, individual resellers settle transactions to exchange LC for PC at an exchange rate that is not set by the authority. These exchange transactions do not create enforceable rights and obligations, and no other markets or exchange mechanisms exist in which a transaction to exchange LC for PC would create such rights and obligations.

IE6 In assessing whether LC is exchangeable into PC, Entity X considers only markets or exchange mechanisms in which a transaction to exchange LC for PC would create enforceable rights and obligations. Entity X concludes that LC is not exchangeable into PC because the exchange transactions with individual resellers do not create enforceable rights and obligations, and no other markets or exchange mechanisms exist in which a transaction to exchange LC for PC would create such rights and obligations.

Example 3—Purpose of obtaining the other currency

IE7 The relevant authority in Entity Y's jurisdiction prevents entities from obtaining PC for purposes other than importing food and medicine.

IE8 In translating the results and financial position of Entity Y, Entity X assesses whether it is able to obtain PC for the purpose of realising its net investment in Entity Y. Because Entity X is prevented from obtaining PC for this purpose, Entity X concludes that LC is not exchangeable into PC. Entity X's ability to obtain PC for the purpose of importing food and medicine is irrelevant to the assessment.

Step II: Estimating the spot exchange rate when a currency is not exchangeable (paragraphs 19A and A11–A16)

Example 4—Using an observable exchange rate for another purpose (paragraphs A11–A14)

Fact pattern

IE9 At 31 December 20X1 the relevant authority in Entity Y's jurisdiction prevents entities from obtaining PC for the purpose of realising a net investment in an entity operating in that jurisdiction. Other than that restriction, entities are able to obtain PC and the LC:PC exchange rate is free-floating. Only one exchange rate applies to transactions for exchanges of LC for PC; it is updated several times a day.

IE10 At the measurement date of 31 December 20X1 Entity X is unable to obtain PC to realise its net investment in Entity Y. Therefore, Entity X concludes that LC is not exchangeable into PC.

Estimating the spot exchange rate

IE11 Because Entity X concludes that LC is not exchangeable into PC, Entity X is required to estimate the spot exchange rate that meets the objective in paragraph 19A.

IE12 Applying paragraphs A11–A14, Entity X considers whether it might use the observable LC:PC exchange rate for the purpose of realising a net investment in an entity. To do so, it assesses whether that observable exchange rate meets the objective in paragraph 19A and considers:

(a) *whether several exchange rates exist*—only one observable exchange rate exists between LC and PC.

(b) *the purpose for which the currency is exchangeable*—Entity X is able to obtain PC for any transaction other than a transaction that would result in the realisation of its net investment in Entity Y.

(c) *the nature of the exchange rate*—the observable exchange rate is free-floating.

(d) *the frequency with which exchange rates are updated*—the observable exchange rate is updated several times a day.

IE13 Considering these factors, Entity X determines that the observable LC:PC exchange rate meets the objective in paragraph 19A. Therefore, Entity X may use that observable exchange rate as the estimated spot exchange rate when it translates the results and financial position of Entity Y.

Example 5—Using the first subsequent exchange rate (paragraphs A11–A12 and A15–A16)

Fact pattern

IE14 At 31 December 20X1 the jurisdiction in which Entity Y operates is subject to hyperinflation. The relevant authority in Entity Y's jurisdiction prevents entities from obtaining PC for the purpose of realising a net investment in an entity operating in that jurisdiction. However, from 30 April 20X2, the authority allows entities to obtain PC for that purpose.

IE15 At the measurement date of 31 December 20X1 Entity X is unable to obtain PC to realise its net investment in Entity Y. Therefore, Entity X concludes that LC is not exchangeable into PC.

Estimating the spot exchange rate

IE16 Because Entity X concludes that LC is not exchangeable into PC, Entity X is required to estimate the spot exchange rate that meets the objective in paragraph 19A.

IE17 Applying paragraphs A11–A12 and A15–A16, Entity X considers whether it might use the first exchange rate at which it is able to obtain the other currency after exchangeability of the currency is restored (first subsequent exchange rate). To do so, it assesses whether that first subsequent exchange rate meets the objective in paragraph 19A and considers:

(a) *the time between the measurement date and the date at which exchangeability is restored*—exchangeability is restored four months after the measurement date.

(b) *inflation rate*—the jurisdiction in which Entity Y operates is subject to hyperinflation.

IE18 Considering these factors, Entity X determines that the first subsequent exchange rate does not reflect the prevailing economic conditions at the measurement date. Therefore, the first subsequent exchange rate does not meet the objective in paragraph 19A for the purpose of realising Entity X's net investment in Entity Y. However, Entity X could adjust that rate, as necessary, to estimate a rate that meets the objective in paragraph 19A for realising its net investment in Entity Y.