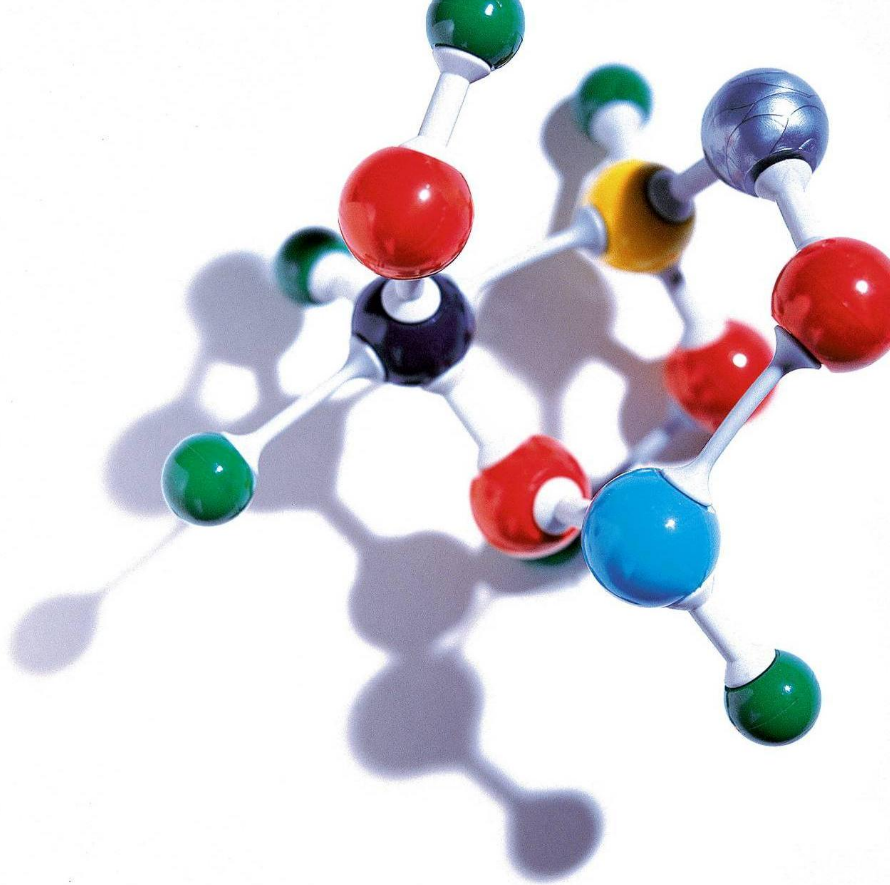
CA

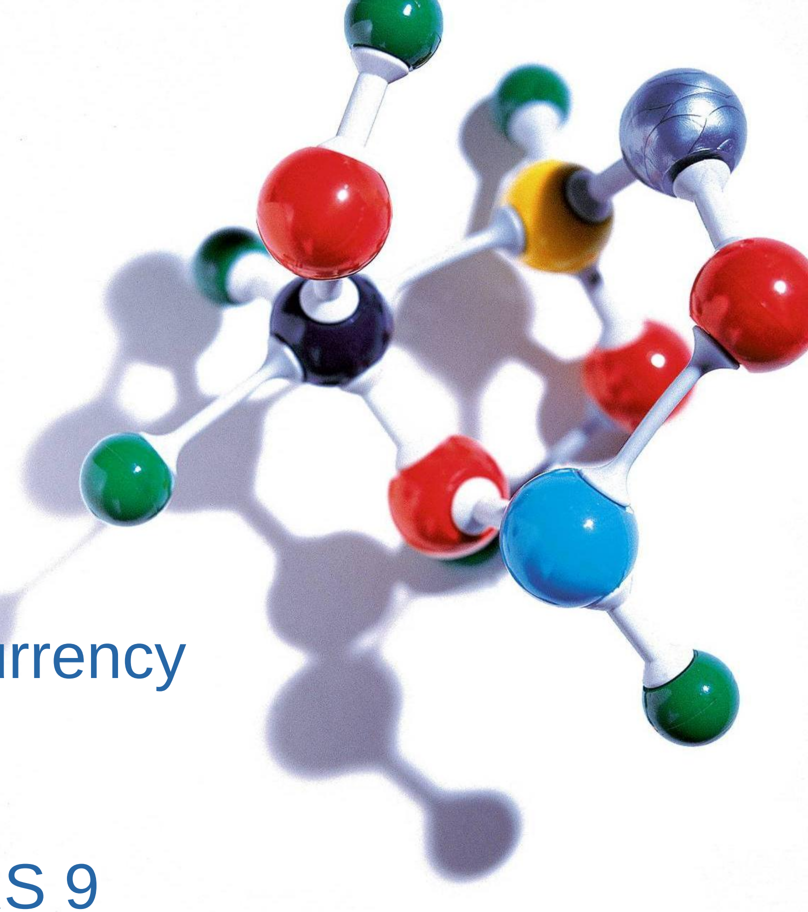
THE INSTITUTE OF
CHARTERED ACCOUNTANTS OF SRI LANKA

IAS 21 - Effects of Changes in Foreign Exchange Rates



IFRS training

Agenda/Contents



Overview
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Section 2: Functional currency to
Presentation currency
Section 3: Interaction of IAS 21 & IFRS 9
Section 4: Consolidation issues
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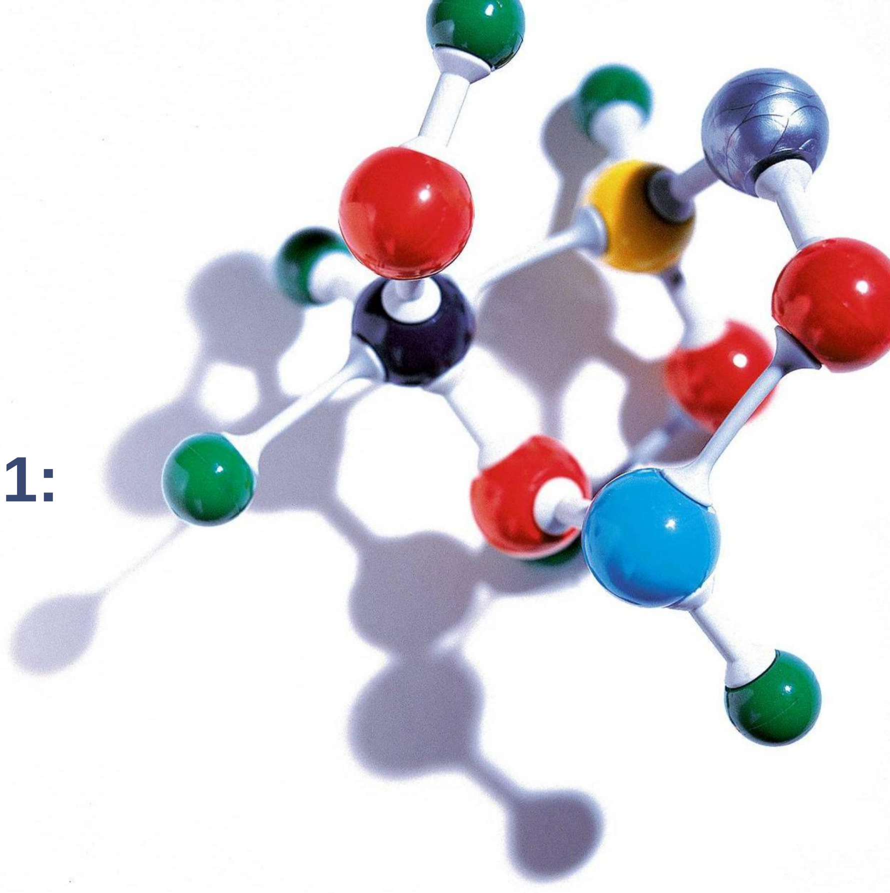
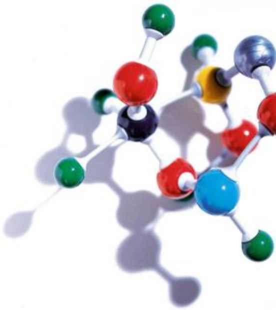
Section One - Overview



Two types of foreign currency translations discussed in IAS 21:

1.1 Reporting foreign currency transactions in the Functional currency.

1.2 Translation of functional currency financial statements to Presentation currency.



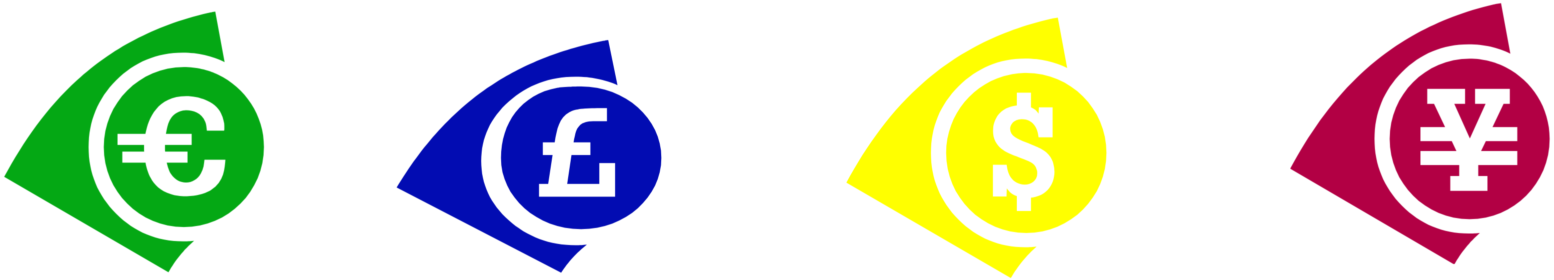
Presentation currency – definition

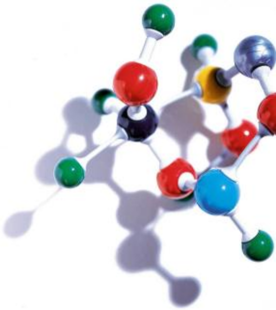
The currency in which the financial statements are prepared.

Its at the discretion of the entity.

Functional currency - definition

Currency of the **primary economic environment** in which the entity operates is the currency in which it primarily **generates and expends cash**





Functional currency – primary indicators

1. Factors to consider:

a. the currency
   - that mainly **influences** sales prices; and
   - 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 the goods/services

Functional currency – example 1

What is the functional currency?

Entity A is trading in the retail sales of computer equipment in the UK. It has the following:

a. All its sales are denominated and settled in pound Sterling

b. The competition within the UK is fierce

c. Labour and other costs are influenced by pound Sterling (70%)

d. Computer equipment is acquired from a US manufacturer with prices denominated in US $ (30%)

Functional currency – secondary indicators

Other factors

a. The currency in which funds from financing activities are generated; and
b. The currency in which receipts from operating activities are retained

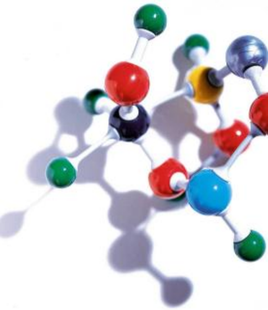
Additional factors for foreign operations / entities

a. Degree of autonomy from the reporting entity;
b. The proportion of transactions with the reporting entity;
c. Whether cash flows are readily available for the reporting entity; and
d. Whether cash flows are sufficient to fund operation

Case 1 – Functional currency of a foreign subsidiary importing products from parent for local distribution

- A subsidiary located in Sri Lanka imports a product manufactured by its US parent at a price denominated in US dollars.
- The product is sold throughout Sri Lanka at prices denominated in LKR, which are determined primarily by competition with similar locally produced products.
- All selling and operating expenses are incurred locally and paid in LKR.
- The operation's long-term financing is primarily in the form of US dollar loans from the parent.
- The distribution of profits is under the parent's control.

Case 1 – Functional currency of a foreign subsidiary importing products from parent for local distribution

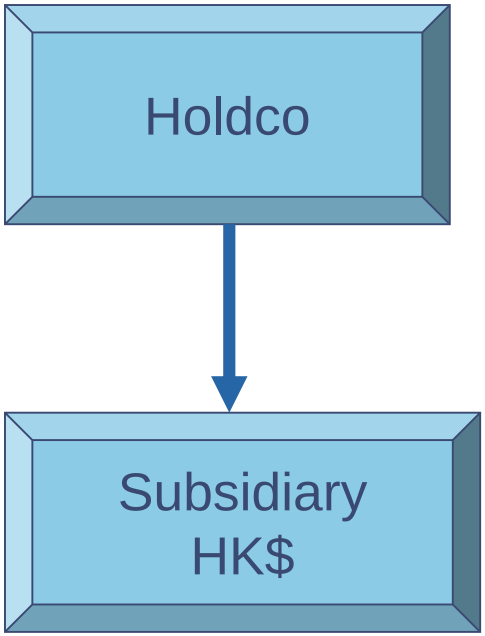


Indicator	**Currency**
Currency that mainly **influences** sales prices	
Currency that mainly **influences** labour, material and other costs	
currency in which financing raised	
The currency in which earnings are retained	
Degree of autonomy and proportionate share of transactions with parent	

Functional currency indicators - summary

- **Focus is on the primary economic environment** - the currency that mainly influences sales prices and costs of providing goods and services
- Also consider – currency used to **generate financing** and **retention of receipts** from operating activities
- If applicable consider – the degree of **autonomy**
- Hierarchy: **Priority** to paragraph 9, before considering the indicators in paragraphs 10 and 11. Para 10 and 11 are designed to provide additional supporting evidence. Judgment necessary

Change of functional currency



An investment Holdco with no operations. Functional currency follows that of subsidiary.

When will the functional currency of Holdco change?

Change of functional currency

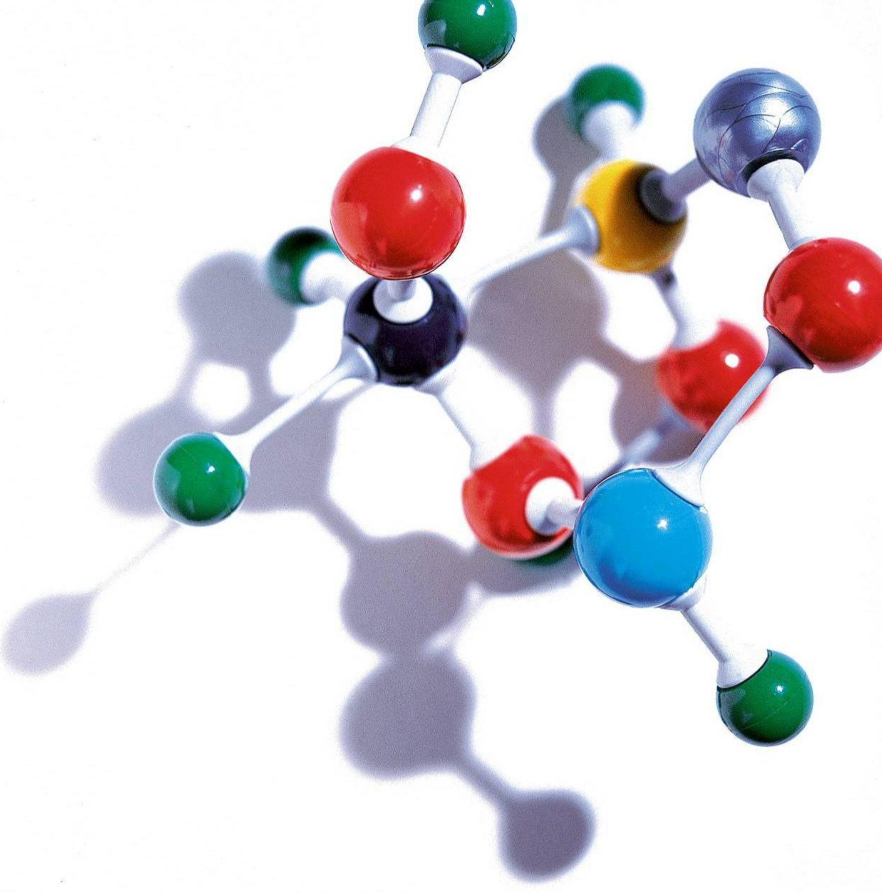
Holdco

Subsidiary – HK$

Subsidiary – US$

Section One

1.1 Reporting foreign currency transactions in the Functional currency.



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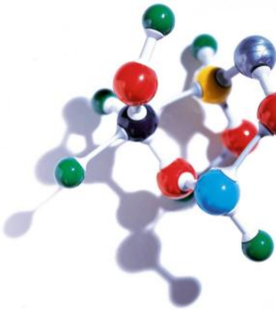


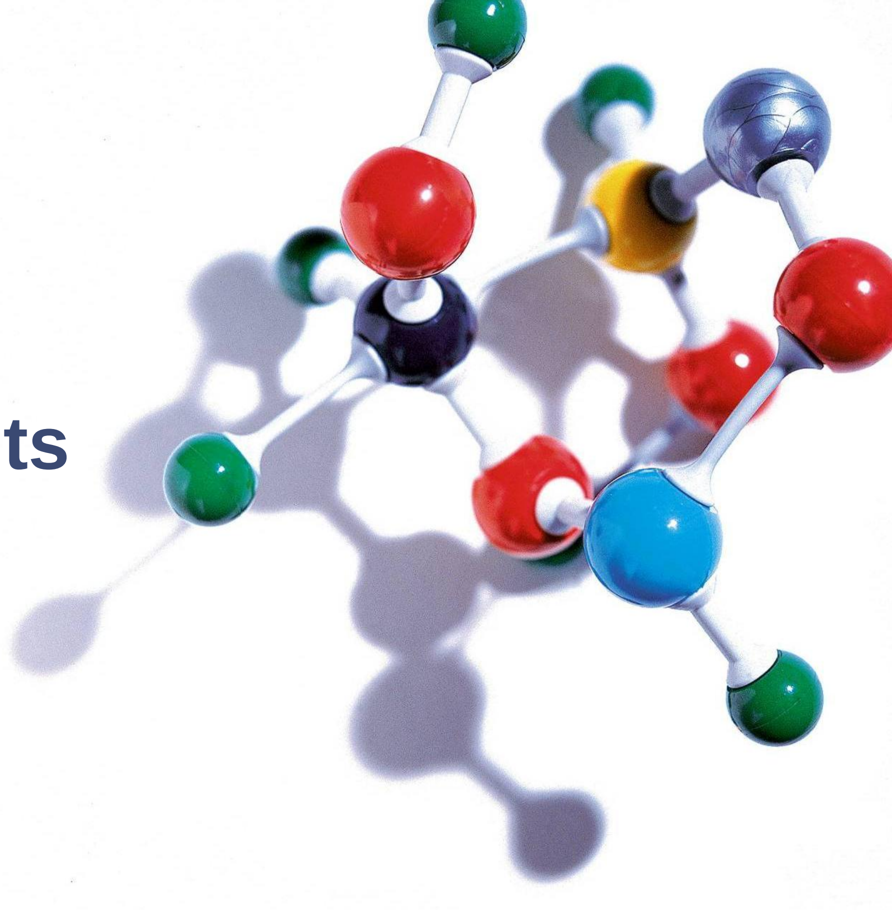
Applicable exchange rates

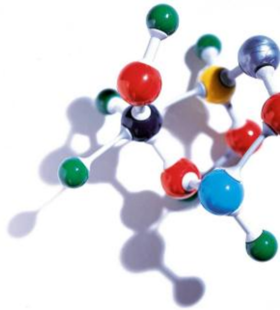
	Initial recognition	Subsequent measurement (at reporting date)
Non-monetary items carried at cost	Spot* rate at date of transaction	Spot* rate at date of transaction
Non-monetary items carried at fair value	Spot* rate at date of transaction	Spot* rate at date of revaluation
Monetary items	Spot* rate at date of transaction	Closing rate at balance sheet date

* For practical reasons the average rate may be used if it approximates actual rate

Section Two

Translation of Functional currency financial statements to Presentation currency





1.1 Translation to presentation currency.

Applicable exchange rates

	Subsequent measurement (at reporting date)
Assets and liabilities	Closing rate at balance sheet date
Income and expenses	Spot* rate at date of transaction **May use average if it approximates actual rate*
Equity	Either at Closing rate or transaction date rate (policy choice)

1.1 Translation to presentation currency.

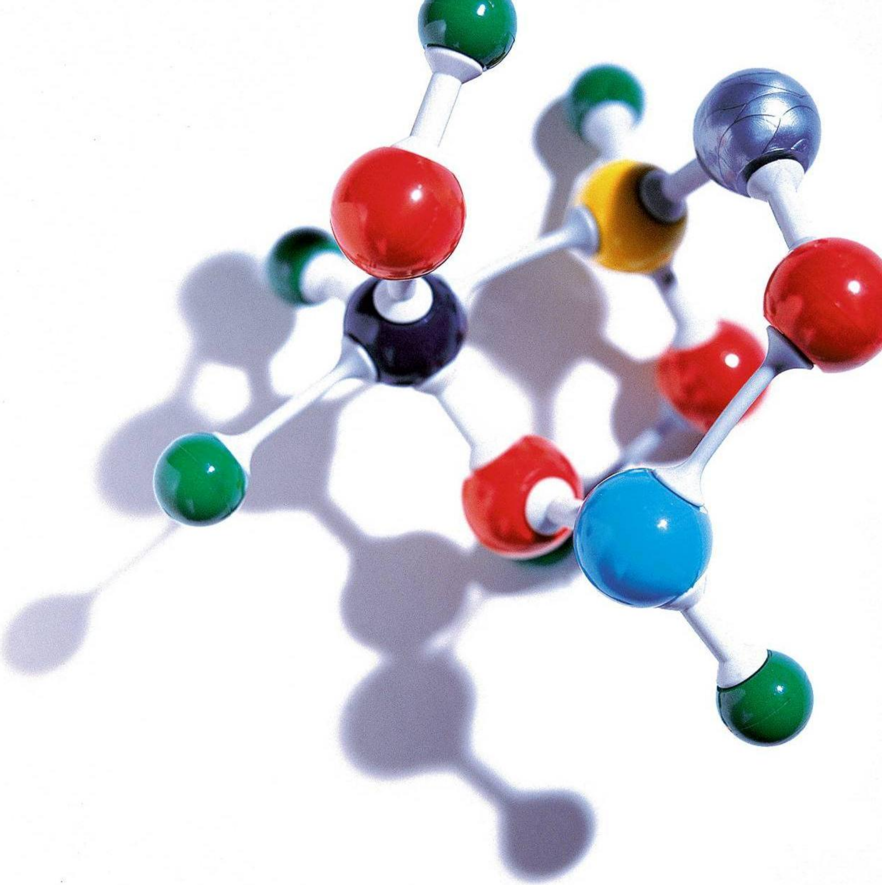
Currency Translation Adjustment (CTA)

The difference arising from the translation of foreign currency to presentation currency is recognised as a **separate component of equity** ("CTA reserve") in the Balance Sheet.

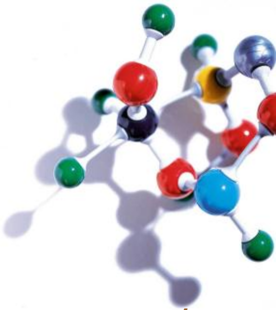
CTA arises from:

- Differences arising from the opening net asset re-translation at closing rates from its previous measurement at last year's closing rates.
- Differences arising from translating the income statement at transaction date rates and asset and liabilities at closing rates.

Section Three – Interaction of IAS 21 and IFRS 9



IFRS training



Interaction between foreign currency and IFRS 9

The measurement principles of IFRS 9 do not override IAS 21 rules, except in the area of hedge accounting.

Initial measurement : All transactions are initially recognised at the spot exchange rates.

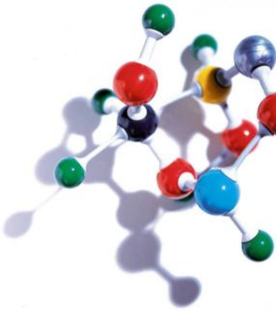
Subsequent measurement – Financial assets/liabilities

*Monetary financial instruments (e.g. debt instruments)**: FVTPL***

- Exchange differences recognized in profit or loss

*Monetary financial instruments (e.g. debt instruments)**: FVTOCI***

- Exchange differences recognized partly in P/L, partly in OCI.

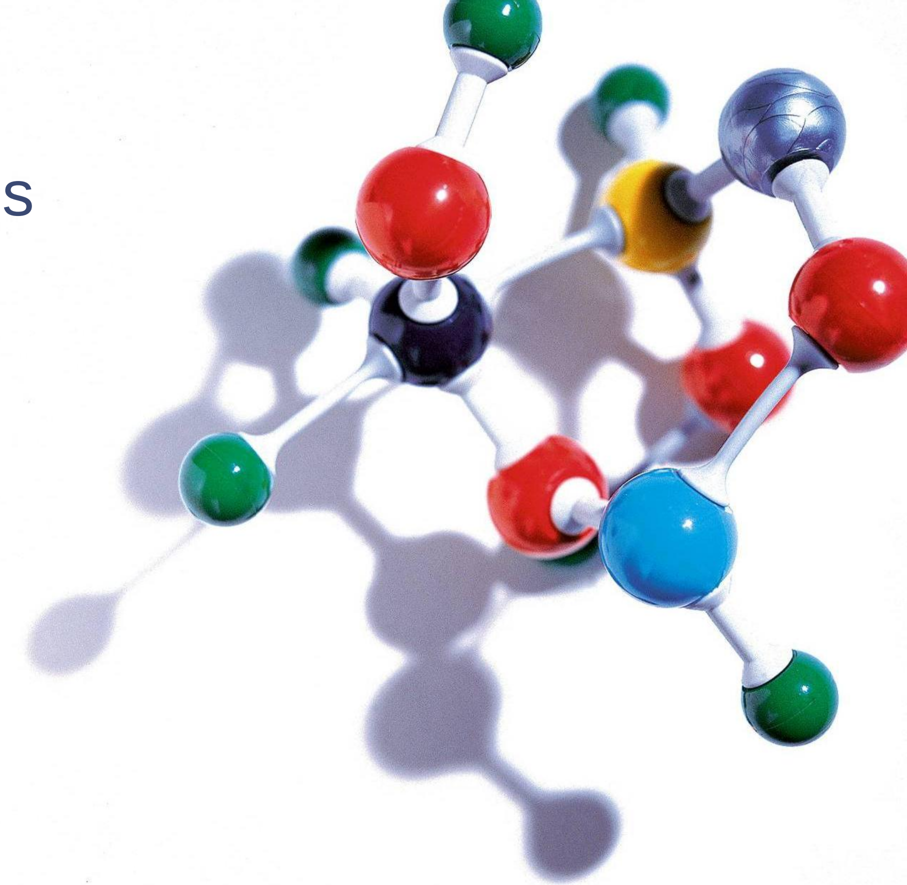


Interaction between foreign currency and IFRS 9

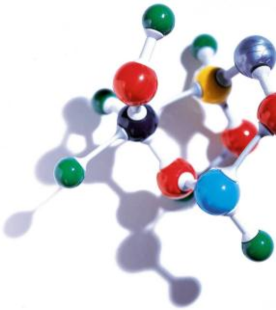
Non-monetary instruments (e.g. equity instruments):

- Where a gain or loss on a non-monetary item is recognised in other comprehensive income, any exchange component of that gain or loss should also be recognised in other comprehensive income.

Section Four – Consolidation issues



Consolidated financial statements – overall procedure



1. Determine the functional currency of each entity within the Group

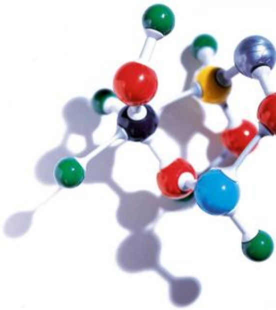
2. Account for all transactions in each entity’s functional currency

3. Prepare all the required information for consolidation purposes in each entity’s functional currency (if applicable include goodwill and fair value adjustments as part of the entity’s assets)

4. If the Group’s presentation currency is different translate all the information into the Group presentation currency

5. Perform consolidation adjustments and prepare the Consolidated Financial Statements

Recycling of CTA – disposals and partial disposals



Disposal of a foreign operation:

In case of partial disposal of a subsidiary, there will be a transfer from CTA to NCI in OCI not the income statement

BEFORE	AFTER	CTA
Subsidiary	Associate	Adjust 100%
Subsidiary	Financial asset - IFRS 9	Adjust 100%
Subsidiary	Subsidiary	Proportional

Do the following events trigger a recycling of CTA?

Impairment of investment of foreign operation

Liquidation or abandonment of foreign operation

Restructuring of group

Dividends paid by foreign operation

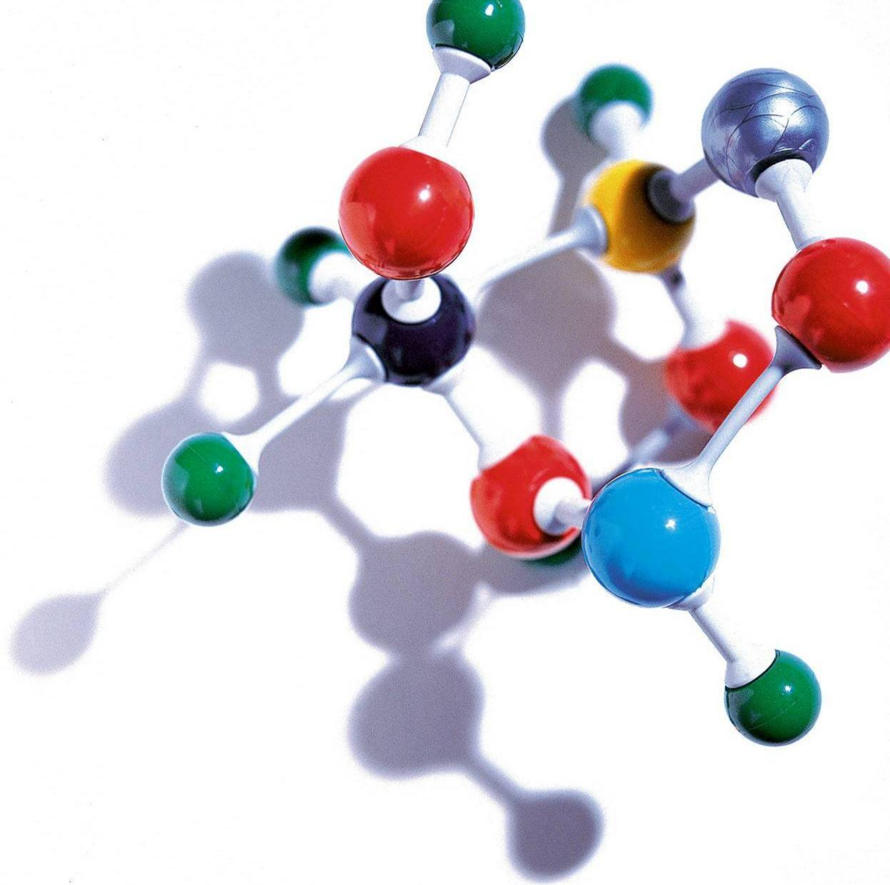
Case 1 – **Could an entity have different functional currencies for stand-alone accounts and for group reporting purposes?**

- Entity ABC is an autonomous foreign operation of reporting entity XYZ. Entity ABC operates in a country where US dollars are frequently used, because the currency of the country in which entity ABC operates has been inflationary in the past.
- Entity ABC primarily operates in the local market and is requested to prepare statutory stand-alone financial statements in accordance with IFRS. Local regulations require entity A to use the local currency as the presentation currency for the statutory accounts.
- Management has determined that the local currency should be the functional currency for the stand-alone financial statements.
- Entity A is also required to prepare an IFRS reporting package for entity Z. Management believes that entity A should use US dollars as the functional currency for group reporting purposes, because US dollars are frequently used in the local economy and because the group presentation currency is US dollars.

Case 1 – Could an entity have different functional currencies for stand-alone accounts and for group reporting purposes?

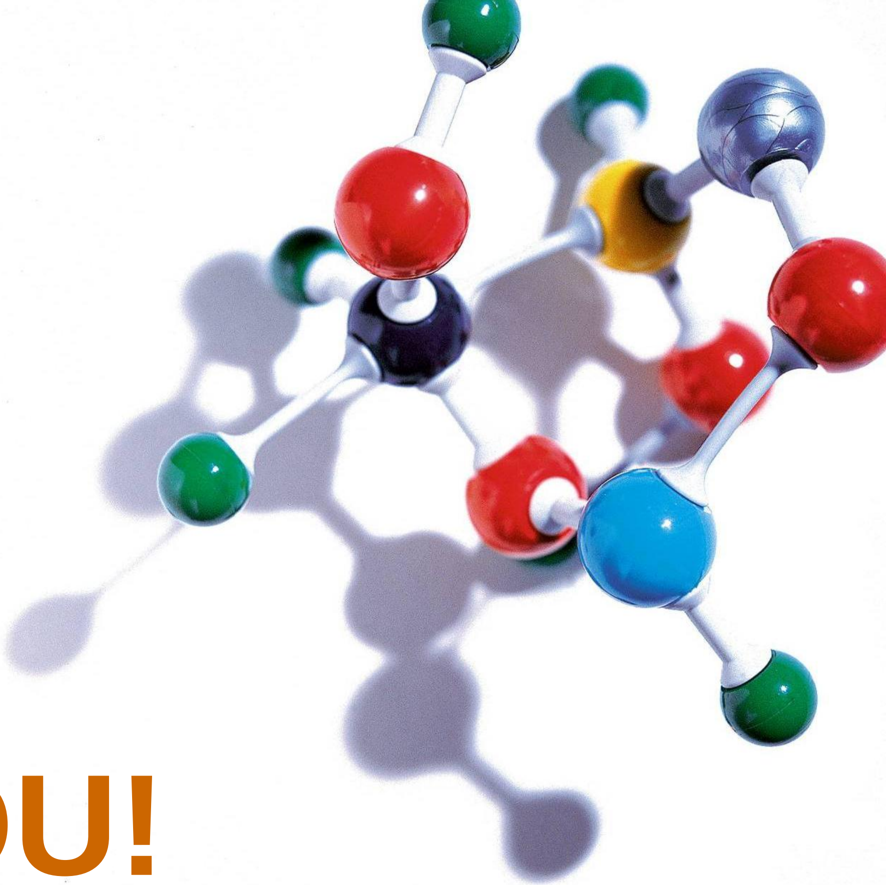
Could an entity have different functional currencies for stand-alone accounts and for group reporting purposes?

Section Five – Conclusion



Conclusion

- Variety of indicators for functional currency
- IAS 21 interaction with IFRS 9
- Be aware of consolidation issues
- Disposal? Recycle the CTA



THANK YOU!