Accounting Standard

AASB 1012
November 2000

Foreign Currency Translation

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Defined words are *italicised* each time they appear. The definitions are in Section 10. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

The Standard is presented in a format that combines the formats previously used in Accounting Standards (AASB Standards) and Australian Accounting Standards (AAS Standards) in order to move towards the issue of a single series of Standards. The Standard applies to all foreign currency transactions, other than foreign currency contracts that are not classified as hedges, and specifies methods of accounting for foreign currency transactions and methods of translating the financial reports of foreign operations. The Standard requires:

(a) assets, liabilities, items of equity, revenues and expenses arising from entering into a foreign currency transaction to be initially recognised and translated using the applicable exchange rates in effect at the date of the transaction;

(b) foreign currency monetary items outstanding at the reporting date, other than a monetary item arising under a foreign currency contract where the exchange rate for that monetary item is fixed in the contract, to be translated using the spot rate at the reporting date;

(c) a monetary item arising under a foreign currency contract outstanding at the reporting date where the exchange rate for the monetary item is fixed in that contract to be translated at the exchange rate fixed in that contract;

(d) exchange differences resulting from the translation of foreign currency monetary items to be recognised as revenues or expenses in the reporting period in which the exchange rates change, unless the exchange difference is to be included in the cost of a qualifying asset or arises from a hedge of a specific purchase or sale up to the date the specific purchase or sale is recognised;

(e) exchange differences relating to foreign currency monetary items forming part of the net investment in a self-sustaining foreign operation, together with hedges of such monetary items and related tax effects, to be eliminated against the foreign currency translation reserve on incorporation of the foreign operation’s financial report into the entity’s financial report;

(f) the financial reports of self-sustaining foreign operations to be translated using the current rate method and the financial reports of integrated foreign operations to be translated using the temporal method;

(g) a change of reporting currency by a foreign operation to be recognised and disclosed as a change in accounting policy;

(h) the balance in the foreign currency translation reserve which relates to the disposal or part disposal of a foreign operation to be transferred from the foreign currency translation reserve to retained profits or accumulated losses by the entity in the period in which the disposal of that foreign operation is recognised;

(i) the financial reports of self-sustaining foreign operations which report to the parent entity in the currency of a hyperinflationary economy to be restated for general price level changes before translation;

(j) gains or costs on entering a transaction classified as a hedge, other than a hedge of a specific purchase or sale, to be deferred and recognised as revenues or expenses over the life of the hedge;

(k) in the case of a hedge of a specific purchase or sale, gains or costs and exchange differences arising up to the date of purchase or sale to be deferred and included in the measurement of the purchase or sale; and

(l) specific disclosures in relation to foreign currency transactions and foreign operations.

ACCOUNTING STANDARD AASB 1012

The Australian Accounting Standards Board makes Accounting Standard AASB 1012 “Foreign Currency Translation” under section 334 of the Corporations Law.

Dated 16 November 2000

F. K. Alfredson
Chair – AASB

ACCOUNTING STANDARD

AASB 1012 “FOREIGN CURRENCY TRANSLATION”

1 Application

1.1 This Standard applies to:

(a) each *entity* that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Law and that is a *reporting entity*;

(b) *general purpose financial reports* of each other *reporting entity*; and

(c) financial reports that are, or are held out to be, *general purpose financial reports*.

1.1.1 The standards specified in this Standard apply to the financial report where information resulting from their application is material in accordance with Accounting Standard AASB 1031 and Australian Accounting Standard AAS 5 “Materiality”. An example of the application of materiality to *foreign currency* translation is the use of average *exchange rates* as an approximation to the *exchange rates* current at the date of each transaction in translating financial reports of *foreign operations* where the result of using average *exchange rates* is not materially different from the result of using the *exchange rates* at the dates of each transaction.

1.1.2 This Standard does not deal with the restatement of an *entity's* financial report from its *reporting currency* into another currency for the convenience of users accustomed to that currency or for similar purposes. Such "convenience translations" do not purport to measure the effects of changes in *exchange rates* upon the *entity*.

1.1.3 The translation of *foreign currency* cash flows is dealt with in Accounting Standard AASB 1026 and Australian Accounting Standard AAS 28 "Statement of Cash Flows" and is to be applied in a manner that is consistent with the provisions of this Standard.

2 Scope

2.1 This Standard applies to:

(a) *foreign currency transactions*, other than *foreign currency contracts* that are not classified as *hedges*; and

(b) the translation of the financial reports of *foreign operations*.

2.1.1 *Foreign currency transactions* include *foreign currency contracts*. This Standard applies to *foreign currency contracts* where those *foreign currency contracts* are classified as *hedges* in accordance with paragraph 6.1. This Standard does not apply to *foreign currency contracts* where those *foreign currency contracts* are not used for *hedging* purposes.

2.1.2 The exclusion of non-hedge *foreign currency contracts* from the scope of this Standard does not exclude an *entity* from having to make disclosures relating to these contracts in accordance with Accounting Standard AASB 1033 and Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments". For example, paragraph 5.2 of AASB 1033 and AAS 33 require the disclosure of the terms, conditions and accounting policies relating to financial instruments and paragraph 5.3 of AASB 1033 and AAS 33 require disclosure of the objectives for holding or issuing *derivative* financial instruments.

3 Operative Date

3.1 This Standard applies to *annual reporting periods* beginning on or after 1 January 2002.

3.2 This Standard may be applied to *annual reporting periods* beginning before 1 January 2002. An *entity* that is required to prepare financial reports in accordance with Part 2M.3 of the

Corporations Law may apply this Standard to *annual reporting periods* beginning before 1 January 2002, where an election has been made in accordance with subsection 334(5) of the Corporations Law.

3.3 When applied or operative, this Standard supersedes:

(a) Accounting Standard AASB 1012 "Foreign Currency Translation", as approved by notice published in the *Commonwealth of Australia Gazette* No. S 222 on 29 July 1988 and amended by Accounting Standard AASB 1025 "Application of the Reporting Entity Concept and Other Amendments"; and

(b) Australian Accounting Standard AAS 20 "Foreign Currency Translation", as issued in December 1987.

3.3.1 Notice of this Standard was published in the *Commonwealth of Australia Gazette* on 17 November 2000.

4 Purpose of Standard

4.1 The purpose of this Standard is to:

(a) specify methods of accounting for *foreign currency transactions*, including *foreign currency hedging* transactions;

(b) specify methods of translating the financial reports of *foreign operations* which reflect the underlying relationships between the *entity* and its *foreign operations;* and

(c) require the disclosure of information which will enable users to assess the significance to the *entity* of movements in *exchange rates*.

5. Translation of Foreign Currency Transactions

Initial Translation

5.1 Subject to paragraph 5.2, each *asset*, *liability*, item of *equity*, *revenue* or *expense* arising from entering into a *foreign currency transaction* must be *recognised* and translated using the *spot rate* at the date of the transaction.

5.1.1 *Foreign currency transactions* include transactions arising when the *entity*:

(a) buys or sells *assets* or services where the price is denominated in a *foreign currency*; or

(b) borrows or lends funds where the amounts payable or receivable are denominated in a *foreign currency*; or

(c) becomes a party to a *foreign currency contract*; or

(d) otherwise acquires or disposes of *assets* or incurs or settles *liabilities* denominated in a *foreign currency*; or

(e) issues *equity*, incurs costs of issuing *equity*, or makes returns of *equity* or returns on *equity* denominated in a *foreign currency*.

5.1.2 Accounting for *foreign currency transactions* will involve one or more of the following stages:

(a) translation to record the transaction as at the transaction date;

(b) adjustments to *monetary items* (receivables and payables) resulting from the transaction to record the effect of movements in *exchange rates* subsequent to the transaction date; and

(c) recording the settlement of those *monetary items*.

5.2 An *asset* or *liability* arising under a *foreign currency contract* where the *exchange rate* for that *asset* or *liability* is fixed in that contract must be *recognised* and translated using that fixed *exchange rate*.

5.2.1 A *foreign currency contract* may give rise to both an *asset* and a *liability*. For example, a contract to purchase a specified amount of *foreign currency* at a specified rate on a specified date gives rise to both an *asset* and a *liability*. The *asset* represents the right to receive *foreign currency* and is translated at the *spot rate* on entering into the contract. The *liability* represents the obligation to pay a pre-determined fixed amount in exchange for the specified amount of *foreign currency*. It is translated at the *exchange rate* fixed in the contract which will not vary over the life of the contract even if the *exchange rate* changes. Paragraph 4.5.1 of Accounting Standard AASB 1033 and Australian Accounting Standard AAS 33 “Presentation and Disclosure of Financial Instruments” notes that a financial asset and financial liability arising under an individual *derivative* financial instrument such as a forward contract is *recognised* as a single (net) asset or liability.

Subsequent Translation

5.3 Subject to paragraph 5.4, *foreign currency monetary items* outstanding at the *reporting date* must be translated at the *spot rate* at the *reporting date*. Other items outstanding at the *reporting date* must not be retranslated subsequent to the initial *recognition* of the transaction.

5.4 *Monetary items* arising under *foreign currency contracts* and outstanding at the *reporting date* must be translated:

(a) where the *exchange rate* is fixed in the contract, at that fixed *exchange rate*; and

(b) where the *exchange rate* varies, at the *spot rate* at the *reporting date*.

5.4.1 At each *reporting date* subsequent to the transaction date, *monetary items* resulting from *foreign currency transactions* other than components of *foreign currency contracts* where the *exchange rate* is fixed in the contract are translated at the *spot rate* at the *reporting date* to determine the equivalent *reporting currency* receivable or payable.

5.5 Subject to paragraphs 5.6 and 6.5, *exchange differences* must be *recognised* as *revenues* or *expenses* in *net profit or loss/result* in the reporting period in which the *exchange rates* change.

5.5.1 *Exchange differences* on *foreign currency monetary items* are determined by comparing the *foreign currency* amount of the item translated at the applicable *exchange rate* at the *reporting date* (or, where the *monetary item* is settled during the reporting period, at the date of settlement) with that same *foreign currency* amount translated at the date on which the original transaction took place (or, if later, the last *reporting date*).

Qualifying Assets

5.6 **Subject to paragraph 7.11(d), when an *exchange difference* arises in respect of a *foreign currency monetary item* which is directly attributable to the acquisition, construction or production of a *qualifying asset*, that difference, net of the effects of a *hedge* of the *monetary item*, must be capitalised as part of the cost of that *asset* in accordance with Accounting Standard AASB 1036 and Australian Accounting Standard AAS 34 "Borrowing Costs".**

Net Investments in Self-Sustaining Foreign Operations

5.7 ***Exchange differences* relating to *foreign currency monetary items* forming part of the *net investment* in a *self-sustaining foreign operation* must be *recognised* as *revenues* or *expenses* in *net profit or loss/result* in the reporting period in which the *exchange rates* change. On incorporation of the *foreign operation* into the *entity's* financial report, the *exchange differences*, together with any income tax expense (income tax revenue) arising from such differences, must be eliminated against the foreign currency translation reserve.**

5.7.1 The classification of a *foreign operation* as self-sustaining is discussed in paragraphs 7.2.3 to 7.2.5. A *net investment* in a *self-sustaining foreign operation* includes any long-term *asset* or *liability* within the *economic entity* related to the acquisition or financing of that operation. An *asset* or *liability* for which realisation or settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an addition to or deduction from the *net investment* in a *self-sustaining foreign operation* because the *asset* or *liability* is in the nature of *equity* finance.

6 Hedging Transactions

6.1 To be classified as a *hedge*, a transaction must:

(a) be designated at inception as a *hedge*; and

(b) while continuing to be classified as a *hedge*, be expected to be effective in mitigating possible adverse financial effects of movements in *exchange rates* resulting from the hedged transaction or anticipated hedged transaction.

6.1.1 When a transaction is undertaken with the primary objective of *hedging*, the *entity* would have designated the transaction as a *hedge* by making a formal record of the designation in the *entity's* records. For financial reporting purposes, transactions cannot be designated as *hedges* on a retrospective basis. A transaction can only be treated as a *hedge* for as long as it continues to be expected to be effective.

6.1.2 The risks associated with changes in *exchange rates* may be mitigated by entering into *hedging* transactions. These transactions may involve *foreign currency contracts* (for example, forward contracts, futures contracts, options) or other *foreign currency transactions* (for example, borrowing in a currency in which a matching receivable is held). *Hedging* transactions can be classified between those relating to specific commitments and those general *hedging* transactions designed to cover overall net actual or anticipated *foreign currency* exposures (or some proportion thereof).

Costs or Gains on Entering Hedges

6.2 Subject to paragraph 6.5, any costs or gains arising at the inception of the *hedge* must be accounted for separately from the *exchange differences* on the *hedging* transactions. The costs or gains must be deferred and *recognised* as *assets* or *liabilities* on entering the *hedging* transactions and amortised as *expenses* or *revenues* in *net profit or loss/result* over the lives of the *hedging* transactions.

6.2.1 In the particular case of a forward contract *hedging* transaction, the cost or gain that arises on entering the *hedge* is measured by the difference between the *spot rate* at the date of the transaction and the *forward rate* specified in the forward contract.

Exchange Differences on Hedges

6.3 *Exchange differences* on *foreign currency monetary items hedging foreign currency* exposures must be determined as the difference between:

(a) the *foreign currency* amount of the *monetary item* translated at the *spot rate* at the *reporting date*, or, where the *hedging* transaction is settled during the reporting period, at the date of settlement; and

(b) the same *foreign currency* amount translated at the later of the date of inception of the *hedge* transaction and the last *reporting date*.

6.4 Subject to paragraphs 5.6 and 6.5, *exchange differences* on *foreign currency monetary items hedging foreign currency* exposures must be *recognised* as *revenues* and *expenses* in *net profit or loss/result* in the reporting period in which the *exchange rates* change.

Hedging Specific Commitments

6.5 In relation to transactions intended to *hedge* specific purchases or sales:

(a) costs or gains arising at the time of entering into the transactions; and

(b) *exchange differences*, to the extent that they arise up to the dates of purchase or sale,

must be deferred and included in the measurement of the purchases or sales.

6.5.1 *Hedges* of specific commitments include those relating to the establishment of:

(a) the price of *assets* or services to be purchased or sold;

(b) the number of units of currency (for example, units of the *domestic* currency) to be paid or received in respect of a *foreign currency* payable or receivable; and

(c) the number of units of currency (for example, units of the *domestic* currency) committed to the *net investment* in a *self-sustaining foreign operation*.

6.5.2 With the exception of *hedging* transactions of the type described in paragraph 6.5.1(a), any *exchange differences* arising on *hedging* transactions (whether or not they relate to specific commitments) are *recognised* as *revenues* and *expenses* in the reporting period in which they arise (that is, when the relevant *exchange rates* change).

6.5.3 When a *hedging* transaction of the type described in paragraph 6.5.1(a) occurs, any costs or gains arising at the time of entering into that transaction and the gain or loss on that transaction up to the date of purchase or sale are deferred and included in the measurement of the purchase or sale transaction. For example, a gain on a *foreign currency contract* undertaken to fix the *domestic* price of an item of equipment at the price current at the time of order is deferred and offset against the translated price of the equipment at the date of acquisition. If the *hedging* transaction extends beyond the date of the recognition of purchase or sale, paragraph 6.5.1(b) applies since it is a *monetary item* that is then being hedged.

6.5.4 Where a *foreign currency monetary item* is hedged, *exchange differences* on the *hedging* item will be determined by reference to movements in *spot rate*s, as will the *exchange differences* on the *hedged monetary item*. This is illustrated in Appendix 2.

6.5.5 A *foreign currency monetary item* may be *hedged* by swapping or exchanging repayment schedules with another party. This will usually involve the *entity* in an arrangement cost and may effectively change the *foreign currency* in which exposure to *exchange rate* changes will occur. A contingency may exist in respect of the original repayment schedule in the event of a default. It is not customary to account for the swap in gross terms, that is by continuing to account for the original *monetary item* and for the offsetting receivable or payable. Once a swap is in place, the *entity* accounts for any *exchange differences* on the adopted *monetary item* as set out in paragraphs 5.1 to 5.6 and *recognises* the arrangement cost by deferring and amortising it over the life of that adopted item.

6.5.6 *Entities* may choose to borrow in a currency in which they will have *foreign currency revenue* available from which to meet instalments or settlement of that borrowing. Alternatively they may be able to arrange *foreign currency revenue* to be available for an existing commitment in that currency. For *foreign currency revenues* to be an effective *hedge* of repayments of a *foreign currency* borrowing, the cash flows of the underlying and *hedging* transactions must be matched. When *entities* match cash flows in this manner they still account separately for the *revenue* and any *exchange differences* on the commitment as specified in paragraphs 6.3 and 6.4.

Early Termination of Foreign Currency Hedges

6.6 **If a *hedge* of an anticipated purchase or sale is terminated early, and the anticipated transaction is still expected to occur as was specified when the hedge was designated, the deferred gains or losses that arose on the *hedge* prior to its termination must continue to be deferred and then included in the measurement of the purchase or sale when it takes place.**

6.7 **If a *hedge* of an anticipated purchase or sale is terminated early and the anticipated transaction is no longer expected to occur as was specified when the hedge was designated, the deferred gains or losses that arose on the *hedge* prior to its termination must be *recognised* as a *revenue* or an *expense* in *net profit or loss/result* as at the date of termination.**

Hedges of Net Investments in Self-Sustaining Foreign Operations

6.8 ***Exchange differences* arising from a *hedge* of a *monetary item* forming part of the *net investment* in a *self-sustaining foreign operation* must be *recognised* as a *revenue* or an *expense* in *net profit or loss/result* in the reporting period in which the *exchange rates* change. To the extent that the *net investment* is *hedged*, on incorporation of the *foreign operation* into the *entity's* financial report the *exchange differences* arising from the *hedge* must be eliminated against the foreign currency translation reserve, together with any income tax expense (income tax revenue) arising from such differences.**

6.8.1 If a transaction is entered into to *hedge* a *monetary item* forming part of the *net investment* in a *self-sustaining foreign operation*, *exchange differences* on the *hedging* transaction are *recognised* in *net profit or loss/result* in the reporting period in which the *exchange rates* change. To the extent that the *exchange differences* after income tax expense (income tax revenue) arising from the *hedging* transaction are no greater than the *exchange differences* after income tax expense (income tax revenue) relating to the *net investment*, the *exchange differences* after income tax expense (income tax revenue) arising from the *hedging* transaction are eliminated against the foreign currency translation reserve on incorporation of the *foreign operation* into the *entity's* financial report. The effect of this is to offset the *exchange differences* arising from the *hedge* against the *exchange differences* arising from the translation of the financial reports of the *self-sustaining foreign operation*.

7 Translation of Financial Reports of Foreign Operations

7.1 The financial reports of a *self-sustaining foreign operation* must be translated as at the *reporting date* using the *current rate method* and any *exchange differences* must be taken directly to the foreign currency translation reserve within *equity* and retained in the foreign currency translation reserve until the disposal, or partial disposal, of the *foreign operation*.

7.2 The financial reports of an *integrated foreign operation* must be translated as at the *reporting date* using the *temporal method* and any *exchange differences* must be *recognised* as *revenues* or *expenses* in *net profit or loss/result* in the reporting period in which they arise.

7.2.1 The objective of translating the financial reports of *foreign operations* into the *reporting currency* of the *entity* is to enable incorporation of those reports into the *entity's* financial report. Translation calculations are illustrated in Appendix 1.

7.2.2 For the purposes of preparing a consolidated financial report, Accounting Standard AASB 1024 "Consolidated Accounts" and Australian Accounting Standard AAS 24 "Consolidated Financial Reports" require information for *foreign operations* to be prepared as at the same date as the *reporting date* of the *economic entity*. For the purposes of including an *associate* in accordance with Accounting Standard AASB 1016 and Australian Accounting Standard AAS 14 "Accounting for Investments in Associates" in the financial report, the *spot rate* to be used is the *spot rate* at the *reporting date* of the *associate*.

Classification of Foreign Operations

7.2.3 The method used to translate *foreign currency* financial reports reflects the financial and other operational relationships which exist between the *entity* and its *foreign operations*. *Foreign operations* are classified on the basis of whether the relationship normally exposes the *entity* to exchange gains or losses. Some *foreign operations* are closely interlinked in terms of their financing, processing, marketing, distribution or other activities with the other operations of the *entity*. That is, they are little more than an extension of the *entity's* other activities. Other *foreign operations* are more remote from the *entity.* The former category of *foreign operations*, termed *integrated foreign operations*, exposes the *entity* to exchange gains or losses which can be measured through the translation of the financial reports of the *foreign operations*. The latter category, termed *self-sustaining foreign operations*, may expose the *entity* to exchange gains or losses in the long run, but does not do so through day-to-day operations.

7.2.4 In determining whether a *foreign operation* is self-sustaining or integrated, the governing determinant will be the effect of that operation's activities on the *entity's* exposure to exchange gains and losses. The *foreign operation* is self-sustaining where the *foreign operation's* activities do not normally or materially expose the *entity* directly to exchange gains and losses because of relative economic independence. Where this is not so, the *foreign operation* is integrated.

7.2.5 Factors which might individually or collectively indicate that a *foreign operation* is self-sustaining include:

(a) there are no material transactions or other interchanges between the *entity* and the *foreign operation* in the course of normal activities;

(b) the cash flows of the *entity* are largely unaffected by the activities of the *foreign operation*;

(c) the sale prices of the *foreign operation's* products or services are not materially influenced by *domestic* conditions and such prices are primarily determined by factors other than changes in *exchange rates*;

(d) the *foreign operation's* major markets do not include the *entity's* country;

(e) the *foreign operation's* costs are not materially affected by *domestic* prices; and

(f) the *foreign operation's* day-to-day financing is not supplied by the *entity*.

Self-Sustaining Foreign Operations

7.2.6 Application of the *current rate method* will give rise to *exchange differences* where, at the *reporting date*, the opening net assets are translated at an *exchange rate* different from the applicable *exchange rate* at the preceding *reporting date*, and where *revenues* and *expenses* are translated at rates other than the *spot rate* at the *reporting date*.

7.2.7 *Exchange differences* arising under the *current rate method* occur because of the need to prepare financial reports for an *entity* with *foreign operations*. These *exchange differences* may bear little or no relation to gains or losses which may ultimately occur in relation to transactions within the *economic entity* or with external parties. It is inappropriate to view any resulting translation difference as a measure of gain or loss. The *exchange differences* are taken directly to the foreign currency translation reserve, a separate reserve in the *equity* section of the *statement of financial position*. This reserve may have a debit or credit balance.

7.2.8 Applying the *current rate method* requires all *assets* and all *liabilities* to be translated at the *spot rate* at the *reporting date*. This method implies that any adjustments to the net assets of the *foreign operation* as at the date of acquisition are *recognised* as if they were performed before translation of the financial reports of the *foreign operation*. As a result, the goodwill *recognised* by the *entity* as distinct from any goodwill of the *foreign operation*, including goodwill on consolidation, is translated at the *exchange rate* at the date of acquisition.

Integrated Foreign Operations

7.2.9 Where an *integrated foreign operation* exists, the objective of translation is to incorporate the effects of the *foreign operation's* activities into the *entity's* financial reports in a manner that achieves the same effect as if those activities had been entered into by the *entity* directly. *Exchange differences* arise mainly from translating the *foreign operation's monetary items* at current rates in the same way as for the *foreign currency monetary items* of the *entity*.

7.2.10 Under the *temporal method*, non-monetary *assets* are translated using historical rates of exchange. They are thus incorporated into the *entity's* financial reports at the amounts at which the *entity* would have carried such *assets* had they been acquired by that *entity* itself and not by the *foreign operation*. The historical rate applicable when a non-current non-monetary *asset* is carried on the *fair value* basis is the *spot rate* at the date of revaluation. The full amount by which the translated *carrying amount* of that *asset* is restated is treated as a revaluation increment or decrement and accounted for in accordance with Accounting Standard AASB 1041 and Australian Accounting Standard AAS 38 "Revaluation of Non-Current Assets".

Review of Translated Assets

7.3 Subject to paragraph 7.4, when, in relation to all *integrated foreign operations* and those *self-sustaining foreign operations* that report to the *parent entity* in the currency of a hyperinflationary economy:

(a) the translated *carrying amount* of a non-monetary *asset* other than *inventory* exceeds its *recoverable amount*[1] translated at the *spot rate* at the *reporting date*; or

(b) the translated *carrying amount* of an item of *inventory* exceeds its *net realisable value* translated at the *spot rate* at the *reporting date*,

the excess must be *recognised* as an *expense* in *net profit or loss/result*.

7.4 When, in relation to all *integrated foreign operations* and those *self-sustaining foreign operations* that report to the *parent entity* in the currency of a hyperinflationary economy, the translated *carrying amount* of a non-current non-monetary *asset* carried on the *fair value* basis in the financial report of the *foreign operation* exceeds its *fair value* translated at the *spot rate* at the *reporting date*, the excess must be *recognised* as a revaluation decrement in accordance with Accounting Standard AASB 1041 and Australian Accounting Standard AAS 38 "Revaluation of Non-Current Assets".

Reclassification of Foreign Operations

7.5 When a *foreign operation* ceases to be an *integrated foreign operation* and the *current rate method* is to be applied instead of the *temporal method*, *exchange differences* arising from translating non-monetary *assets* and *liabilities* at the current rate at the date of reclassification instead of at the historical

1 Exposure Draft ED 99 "Impairment of Assets" proposes changes to the application of the recoverable amount test.

rates must be taken directly to the foreign currency translation reserve within *equity*.

7.6 **When a *foreign operation* ceases to be a *self-sustaining foreign operation* and the *temporal method* is to be applied instead of the *current rate method*, the translated amounts of non-monetary *assets* at the date of reclassification must be regarded as the costs of those *assets* for the purposes of applying the *temporal method*.**

7.6.1 When a *foreign operation* ceases to be a *self-sustaining foreign operation* and is reclassified as an *integrated foreign operation*, a foreign currency translation reserve is likely to exist. This foreign currency translation reserve contains *exchange differences* which are not *recognised* as *revenues* or *expenses* at the date of reclassification. Rather, the foreign currency translation reserve represents a component of the *equity* of the *integrated foreign operation* and is retained within *equity* until the full or partial disposal of the *foreign operation*. In accordance with paragraph 7.10, the balance of the foreign currency translation reserve relating to the disposal is transferred to retained profits (surplus) or accumulated losses (deficiency) in the reporting period in which the disposal is *recognised*.

Foreign Investments Accounted for by the Equity Method

7.7 **When an investment in a *foreign operation* is accounted for by the equity method, the financial reports of the *foreign operation* must be translated into the *reporting currency* prior to applying the equity method in accordance with Accounting Standard AASB 1016 and Australian Accounting Standard AAS 14 "Accounting for Investments in Associates".**

Change of Reporting Currency

7.8 **Subject to paragraph 7.9, a change in *reporting currency* by a *foreign operation* must be *recognised* and disclosed by the *entity* as a change in an accounting policy.**

7.9 **A change of its *reporting currency* by a *foreign operation* is not a change in an accounting policy where:**

(a) the *foreign operation* changes its currency to a regional currency and a fixed *exchange rate* between the original

***reporting currency* and the regional currency is specified by the body governing the regional currency; or**

(b) the change is only a change of name or currency unit made by the responsible government.

7.9.1 The *reporting currency* used by an *entity* may differ from its *domestic* currency. In particular, a *foreign operation* may change the currency in which it functions and reports to its *parent entity*. For example, a *foreign operation* may operate and report in an economy which becomes hyperinflationary. In such a case, the *foreign operation* may be able to function and report to its *parent entity* in the currency of a more stable economy. A change in its *reporting currency* from the currency of the hyperinflationary economy to the more stable currency, and the effects of that change, is *recognised* and disclosed as a change in an accounting policy.

7.9.2 A change to a regional currency, such as that arising from the introduction of the Euro, is not considered to be a change in *reporting currency* for a *foreign operation* that previously prepared its financial reports in one of the currencies replaced by the Euro. Similarly, a *foreign operation* does not *recognise* and disclose a change in *reporting currency* as a change in accounting policy only by virtue of:

(a) the responsible government changing the name of the *reporting currency*; or

(b) the responsible government changing the currency unit by a fixed formula, such as making each new currency unit equal to one hundredth of the former currency unit.

Disposal of a Foreign Operation

7.10 On the disposal, or partial disposal, of a *self-sustaining foreign operation* or an *integrated foreign operation* previously classified as a *self-sustaining foreign operation*, that part of the balance of the foreign currency translation reserve which relates to the disposal, or partial disposal, must be transferred to retained profits (surplus) or accumulated losses (deficiency) by the *entity* in the reporting period in which the disposal, or partial disposal, is *recognised*.

Self-Sustaining Foreign Operations in Hyperinflationary Economies

7.11 **When a *self-sustaining foreign operation* reports to the *parent entity* in the currency of a hyperinflationary economy, the financial reports must be restated prior to the application of paragraph 7.1. Restatement of the financial reports of the *foreign operation* requires:**

(a) inflation of items of *equity* and non-monetary *assets* and *liabilities* by applying the proportionate changes in a general price level index from the latest of the contribution, acquisition, previous restatement or revaluation dates to the *reporting date*, except where non-monetary *assets* and *liabilities* are carried at the *reporting date* on bases which reflect current price levels;

(b) inflation of *revenues* and *expenses* by applying the proportionate changes in a general price level index from the transaction dates to the *reporting date*;

(c) *recognition* of the gain or loss from holding net monetary items as a *revenue* or an *expense* in *net profit or loss/result*;

(d) *recognition* of all components of borrowing costs that compensate for the effects of inflation and have been included in the cost of a *qualifying asset* as *revenues* or *expenses* in *net profit or loss/result* in the reporting period in which they are incurred; and

(e) *recognition* of any balancing item as a *revenue* or an *expense* in *net profit or loss/result*.

7.11.1 A *self-sustaining foreign operation* which operates in a hyperinflationary economy may function and report to the *parent entity* in the currency of a more stable economy. In this case, the *current rate method* is applied to the financial reports as required by paragraph 7.1. Where the *self-sustaining foreign operation* reports to the *parent entity* in the currency of the hyperinflationary economy, restatement of the financial reports is required prior to the application of paragraph 7.1. For the purposes of this Standard, hyperinflation is indicated by the cumulative inflation rate over three years approaching or exceeding 100 per cent.

7.11.2 Non-monetary *assets* and *liabilities* may be carried at the *reporting date* on bases which reflect current price levels such as *net realisable value*, market value or current cost. In addition, some *assets* and *liabilities* such as index-linked bonds and loans may be linked by agreement to changes in prices and the *carrying amounts* of the *assets* and the *liabilities* will be adjusted in accordance with the agreement before the preparation of the financial reports in order to ascertain the amount outstanding at the *reporting date*. In all of these cases, restatement is not required because the impact of hyperinflation has already been included in the *carrying amount* of the *asset* or *liability*. All other non-monetary *assets*, *liabilities*, items of *equity*, *revenues* and *expenses* are inflated by applying the proportionate changes in a general price level index.

7.11.3 Monetary *assets* and *liabilities* are not restated under this Standard because they are already expressed in terms of the monetary unit current at the *reporting date*. In a period of inflation, an *entity* holding net monetary assets loses purchasing power, whereas an *entity* holding net monetary liabilities gains purchasing power. The gain or loss arising from holding a net monetary position is *recognised* as a *revenue* or an *expense*. Users of financial reports may find this information more useful if the gain or loss on holding a net monetary position is presented together with items such as interest *revenue* and *expense*, the gain or loss on restating *assets* and *liabilities* linked by agreement to changes in prices, and *exchange differences* related to invested or borrowed funds.

7.11.4 In the case of a *qualifying asset* of a *self-sustaining foreign operation* that reports to the *parent entity* in the currency of a hyperinflationary economy, it is not appropriate both to restate the capital expenditure financed by borrowing and to capitalise that part of the borrowing costs caused by *exchange differences* or which compensates for inflation during the same period. It follows that these components of borrowing costs are *recognised* as *revenues* or *expenses* in the reporting period during which the borrowing costs are incurred.

7.12 When a *self-sustaining foreign operation* first reports to the *parent entity* in the currency of a hyperinflationary economy, the components of *equity* other than any revaluation reserve and retained profits (surplus) or accumulated losses (deficiency) must be restated as at the beginning of the reporting period by applying the proportionate changes in a general price level index from the dates the components were contributed or otherwise arose. Any revaluation reserve that arose in previous reporting periods must be eliminated. Restated retained profits (surplus)

or accumulated losses (deficiency) must be derived from all the other amounts in the restated *statement of financial position*.

7.13 **When an economy ceases to be hyperinflationary, an *entity* that previously restated its financial reports in accordance with paragraphs 7.11 and 7.12 must use the *foreign currency* amounts in the financial report prepared at the end of the preceding reporting period as the basis for the *carrying amounts* of *assets* and *liabilities* at the beginning of the current reporting period.**

8 Disclosures

8.1 **The *entity* must disclose the amount of the net *exchange difference* and gain or loss *recognised* as either a *revenue* or an *expense* in *net profit or loss/result* for the reporting period.**

8.2 **When there is a change in the classification of a *foreign operation* from self-sustaining to integrated or from integrated to self-sustaining, the *entity* must disclose:**

(a) **the nature of the change in classification;**

(b) **the reason for the change;**

(c) **the net impact on *equity* of the change in classification; and**

(d) **the financial effect on the *statement of financial performance* for the current and preceding reporting periods had the change in classification occurred at the beginning of the preceding reporting period.**

8.3 **An *entity* incorporating in its financial report a *self-sustaining foreign operation* which reports to the *parent entity* in the currency of a hyperinflationary economy must disclose, as a result of the restatement of the financial report of the *self-sustaining foreign operation*:**

(a) **the gain or loss on net *monetary items*;**

(b) **the identity and level of the general price level index at the *reporting date*; and**

(c) **the movement in the general price level index during the reporting period.**

9 Transitional Provisions

9.1 Subject to paragraph 9.2, the accounting policies required by this Standard must be applied as at the beginning of the reporting period to which this Standard is first applied. Where this gives rise to initial adjustments which would otherwise be *recognised* in *net profit or loss/result*, the net amount of those adjustments, including any adjustments to deferred income tax balances, must be adjusted directly against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.

9.2 Where the *entity* has:

(a) issued *equity* denominated in a *foreign currency*; and

(b) retranslated that *equity* at a subsequent *reporting date* prior to the application of this Standard,

the effects of the retranslation must be reversed as at the beginning of the reporting period to which this Standard is first applied.

10 Definitions

10.1 In this Standard:

***annual reporting period* means the *financial year* or similar period to which an annual financial report relates**

***assets* means future economic benefits controlled by the *entity* as a result of past transactions or other past events**

***associate* means an investee, not being:**

(a) a *subsidiary* of the investor; or

(b) a partnership of the investor; or

(c) an investment acquired and held exclusively with a view to its disposal in the near future

over which the investor has *significant influence*

carrying amount **means, in relation to an** ***asset*** **or a** ***liability*****, the amount at which the** ***asset*** **or** ***liability*** **is recorded in the accounting records as at a particular date**

control **means the capacity of an** ***entity*** **to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another** ***entity*** **so as to enable that other** ***entity*** **to operate with it in pursuing the objectives of the controlling** ***entity***

current rate method **means a method of translating the financial reports of a** ***foreign operation*** **whereby:**

(a) ***assets*** **and** ***liabilities*** **are translated at the** ***spot rate*** **at the** ***reporting date*****;**

(b) ***equity*** **at the date of investment, including in the case of a corporation, share capital at acquisition and pre-acquisition reserves, is translated at the** ***exchange rate*** **current at that date;**

(c) post-acquisition movements in ***equity*****, other than retained profits (surplus) or accumulated losses (deficiency), are translated at the** ***exchange rates*** **current at the dates of those movements, except that where a movement represents a transfer between items within** ***equity*** **or a return of** ***equity*****, the movement is translated at the** ***exchange rate*** **current at the date that the amount transferred or returned was first included in** ***equity*****;**

(d) distributions from retained profits (that is, dividends paid or proposed, or their equivalent) are translated at the ***exchange rates*** **current at the dates when the distributions were first** ***recognised*****; and**

(e) ***revenue*** **and** ***expense*** **items are translated at the** ***exchange rates*** **current at the applicable transaction dates except that** ***revenues*** **and** ***expenses*** **that have been restated in accordance with paragraph 7.11 are translated at the** ***spot rate*** **at the** ***reporting date***

derivative **means a financial instrument:**

(a) whose value changes in response to the change in a specified interest rate, security price, commodity price, foreign ***exchange rate*****, index of prices or**

rates, a credit rating or credit index, or similar variable (sometimes called the 'underlying');

(b) that requires no initial net investment or little initial net investment relative to other types of contracts that have a similar response to changes in market conditions; and

(c) that is settled at a future date

domestic* means pertaining to the country of the *entity

economic entity* means a group of *entities* comprising the *parent entity* and each of its *subsidiaries

***entity* means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives**

equity* means the residual interest in the *assets* of the *entity* after deduction of its *liabilities

exchange difference* means the difference resulting from translating the same number of units of *foreign currency* at differing *exchange rates

***exchange rate* means a ratio for the exchange of two currencies at a particular time**

***expenses* means consumptions or losses of future economic benefits in the form of reductions in *assets* or increases in *liabilities* of the *entity*, other than those relating to distributions to owners, that result in a decrease in *equity* during the reporting period**

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

foreign currency* means a currency other than the *reporting currency* of the *entity

foreign currency contract* means a *derivative* involving an agreement to exchange different currencies, or to have an option to exchange different currencies, at a specified future date and at a specified *exchange rate

foreign currency transaction **means a transaction that is denominated in or requires settlement in a** ***foreign currency***

foreign operation **means an** ***entity*** **for which financial reports are prepared in a** ***foreign currency*****, including branches,** ***associates*** **and** ***controlled entities***

general purpose financial report **means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs**

hedging **means action taken, whether by entering into a** ***foreign currency contract*** **or otherwise, with the objective of mitigating possible adverse financial effects of movements in** ***exchange rates***

integrated foreign operation **means a** ***foreign operation*** **that is financially and operationally interdependent, either directly or indirectly, with the** ***entity*** **and whose day-to-day operations normally expose the** ***entity*** **to foreign exchange gains or losses**

inventories **means** ***assets*****:**

(a) held for sale in the ordinary course of business; or

(b) in the process of production, preparation or conversion for such sale; or

(c) in the form of materials or supplies to be consumed in the production of goods or services available for sale

excluding depreciable assets, as defined in Accounting Standard AASB 1021 and Australian Accounting Standard AAS 4 "Depreciation"

liabilities **means the future sacrifices of economic benefits that the** ***entity*** **is presently obliged to make to other** ***entities*** **as a result of past transactions or other past events**

monetary items **means money held and** ***assets*** **and** ***liabilities*** **to be received or paid in fixed or determinable amounts of money**

net investment **means the** ***entity's*** **proportionate** ***ownership interest*** **in the net assets of a** ***foreign operation*** **together with any long-term balances within the** ***economic entity*** **related to the acquisition or financing of that operation**

net profit or loss/result **means:**

(a) in the case of an ***entity*** **that is not an** ***economic entity*****, profit or loss/result after income tax expense (income tax revenue) from ordinary activities and extraordinary items; and**

(b) in the case of an ***entity*** **that is an** ***economic entity*****, profit or loss/result after income tax expense (income tax revenue) from ordinary activities and extraordinary items, before adjustment for that portion that can be attributed to outside equity interest**

net realisable value **means the estimated proceeds of sale less, where applicable, all further costs to the stage of completion and less all costs to be incurred in marketing, selling and distribution to customers**

ownership interest **means the** ***equity*** **interest held by an** ***entity*** **directly, and/or indirectly through another** ***entity***

parent entity **means an** ***entity*** **which** ***controls*** **another** ***entity***

qualifying asset **means an** ***asset*** **that necessarily takes a substantial period of time to get ready for its intended use or sale**

recognised **means reported on, or incorporated in amounts reported on, the face of the** ***statement of financial performance*** **or the** ***statement of financial position*** **(whether or not further disclosure of the item is made in the notes)**

recoverable amount **means, in relation to an** ***asset*****, the net amount that is expected to be recovered through the cash inflows and outflows arising from its continued use and subsequent disposal**

reporting currency **means the currency used in presenting the financial report**

reporting date **means the end of the reporting period to which the financial report relates**

reporting entity **means an** ***entity*** **(including an** ***economic entity*****) in respect of which it is reasonable to expect the existence of users dependent on** ***general purpose financial reports*** **for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources, and includes but is not limited to the following:**

(a) ***a disclosing entity*****; and**

(b) **a** ***company*** **which is not a** ***subsidiary*** **of a** ***holding company*** **incorporated in Australia and which is a** ***subsidiary*** **of a foreign** ***company*** **where that foreign** ***company*** **has its securities listed for quotation on a** ***stock market*** **or those securities are traded on a** ***stock market***

revenues **means the inflows or other enhancements, or savings in outflows, of future economic benefits in the form of increases in** ***assets*** **or reductions in** ***liabilities*** **of the** ***entity*****, other than those relating to contributions by owners, that result in an increase in** ***equity*** **during the reporting period**

self-sustaining foreign operation **means a** ***foreign operation*** **that is not an** ***integrated foreign operation*****, being an operation that is financially and operationally independent of the** ***entity*** **and whose operations do not normally expose the** ***entity*** **to foreign exchange gains or losses**

significant influence **means the capacity of an** ***entity*** **to affect substantially (but not** ***control*****) either, or both, of the financial and operating policies of another** ***entity***

spot rate **means the** ***exchange rate*** **for immediate delivery of currencies to be exchanged**

subsidiary **means an** ***entity*** **which is** ***controlled*** **by a** ***parent entity***

temporal method **means a method of translating the financial report of a** ***foreign operation*** **whereby:**

(a) **(i)** ***monetary items*** **are translated at the** ***spot rate*** **at the** ***reporting date*****; and**

(ii) **non-monetary items are translated at *exchange rates* current at the transaction dates or, where a non-monetary item has been revalued or written-down or the write-down has been reversed, at the *exchange rate* current at the date of revaluation, write-down or reversal;**

(b) ***equity* at the date of investment, including in the case of a corporation, share capital at acquisition and pre-acquisition reserves, is translated at the *exchange rate* current at that date;**

(c) **post-acquisition movements in *equity*, other than retained profits (surplus) or accumulated losses (deficiency), are translated at the *exchange rates* current at the dates of those movements, except that where a movement represents a transfer between items within *equity* or a return of *equity*, the movement is translated at the *exchange rate* current at the date that the amount transferred or returned was first included in *equity*;**

(d) **distributions from retained profits (that is, dividends paid or proposed, or their equivalent) are translated at the *exchange rates* current at the dates when the distributions were first *recognised*; and**

(e) ***revenue* and *expense* items are translated at the *exchange rates* current at the applicable transaction dates, except that:**

(i) ***revenues* and *expenses* (including depreciation) that relate to non-monetary items are translated at the rates used to translate those non-monetary items; and**

(ii) ***revenues* and *expenses* that have been restated in accordance with paragraph 7.11 are translated at the *spot rate* at the *reporting date*.**

Annual Reporting Period

10.1.1 The definition of *annual reporting period* refers to *financial year* or similar period and will normally be a twelve-month period. The *annual reporting period* will differ from twelve months in circumstances such as:

(a) the *entity* being established on a date other than a date exactly twelve months before the *reporting date*; and

(b) the *entity* changing its *reporting date*.

Corporations Law Definitions

10.2 In this Standard, the following definitions apply to each *entity* that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Law:

***company* is defined in the Corporations Law**

***disclosing entity* is defined in the Corporations Law**

***financial year* is defined in the Corporations Law**

***holding company* is defined in the Corporations Law**

***statement of financial performance* means profit and loss statement as required by the Corporations Law**

***statement of financial position* means balance sheet as required by the Corporations Law**

***stock market* is defined in the Corporations Law.**

APPENDIX 1

Translation of Financial Reports of Foreign Operations

This Appendix forms part of the commentary and is provided for illustrative purposes only. It illustrates the translation of the financial reports of a foreign operation when it is:

(a) an integrated foreign operation; and

(b) a self-sustaining foreign operation.

Data

Investor Ltd formed Subsidiary Ltd, a foreign operation reporting in $FC currency, on 30 June 20X0 and subscribed all of the issued capital of $FC100,000. Subsidiary Ltd raised a further $FC200,000 in the form of a 5 year loan (repayable in 5 equal annual instalments on 30 June of each year). Fixed assets of $FC201,701 were also acquired on 30 June 20X0. The buildings and plant and equipment have estimated lives of twenty and ten years respectively.

The spot rates relevant to translating Subsidiary Ltd's financial reports are as follows:

30 June 20X0	$FC1.00 = $A1.70
30 June 20X1	$FC1.00 = $A2.00

During the year to 30 June 20X1 a representative average exchange rate is $FC1.00 = $A1.80. Inventory on hand at the end of that year was acquired when the exchange rate was $FC1.00 = $A1.95.

At 30 June 20X0, the result from translating the statement of financial position of Subsidiary Ltd would be the same under both the temporal method (used for integrated foreign operations) and the current rate method (used for self-sustaining foreign operations). This is because exchange rates have not changed between acquisition and reporting date (i.e. historical and current rates are the same at 30 June 20X0).

As there have been no transactions affecting the statement of financial performance by 30 June 20X0, only the statement of financial position is dealt with on the following page.

SUBSIDIARY LTD (Integrated and Self-Sustaining Foreign Operation)

Statement of Financial Position as at 30 June 20X0

	$FC	*Exchange Rate*	*$A*
Current Assets			
Cash at Bank	98,299	1.70	167,108
Total Current Assets	98,299		167,108
Non-Current Assets			
Land	21,111	1.70	35,889
Buildings	110,040	1.70	187,068
Plant & Equipment	70,550	1.70	119,935
Total Non-Current Assets	201,701		342,892
Total Assets	$300,000		$510,000
Current Liabilities			
Loan	40,000	1.70	68,000
Total Current Liabilities	40,000		68,000
Non-Current Liabilities			
Loan	160,000	1.70	272,000
Total Non-Current Liabilities	160,000		272,000
Total Liabilities	$200,000		$340,000
Net Assets	$100,000		$170,000
Equity			
Paid-up Capital	100,000	1.70	170,000
Total Equity	$100,000		$170,000

As at 30 June 20X0, Investor Ltd would consolidate the above statement of financial position under both the temporal and the current rate methods by eliminating the issued capital of Subsidiary Ltd against its investment in Subsidiary Ltd and aggregating all remaining items.

Year Ended 30 June 20X1

The consolidation worksheets for Investor Ltd and Subsidiary Ltd are shown in Schedule 1 (integrated foreign operation) and Schedule 2 (self-sustaining foreign operation) for the year ended 30 June 20X1.

SCHEDULE 1 INTEGRATED FOREIGN OPERATION

Statements of Financial Position as at 30 June 20X1

	Investor *$A*	*Subsidiary* *$FC*	*Exchange Rate*	*Subsidiary* *$A*	*Adjustment* *DR*	*CR*	*Consolidated* *$A*
Current Assets							
Cash at Bank	67,589	78,011	2.00	156,022			223,611
Trade Debtors	45,000	45,000	2.00	90,000			135,000
Inventories	55,000	87,000	1.95	169,650			224,650
Total Current Assets	167,589	210,011		415,672			583,261
Non-Current Assets							
Investment in Subsidiary	170,000	–		–		170,000	–
Land	330,314	21,111	1.70	35,889			366,203
Buildings	208,086	104,538	W/S 1.2	177,715			385,801
Plant & Equipment	1,150,000	63,495	W/S 1.2	107,941			1,257,941
Total Non-Current Assets	1,858,400	189,144		321,545			2,009,945
Total Assets	$2,025,989	$399,155		$737,217			$2,593,206
Current Liabilities							
Trade Creditors	5,675	28,900	2.00	57,800			63,475
Loan	–	40,000	2.00	80,000			80,000
Provision for Income Tax	195,314	50,717	2.00	101,434			296,748
Total Current Liabilities	200,989	119,617		239,234			440,223
Non-Current Liabilities							
Loan	300,000	120,000	2.00	240,000			540,000
Total Non-Current Liabilities	300,000	120,000		240,000			540,000
Total Liabilities	500,989	239,617		479,234			980,223
Net Assets	$1,525,000	$159,538		$257,983			$1,612,983
Equity							
Paid-up Capital	850,000	100,000	1.70	170,000	170,000		850,000
Retained Profits	675,000	59,538	S of Fin Perf	87,983			762,983
Total Equity	$1,525,000	$159,538		$257,983			$1,612,983

SCHEDULE 1 (cont.)

Statements of Financial Performance for the year ended 30 June 20X1

	Investor	*Subsidiary*	*Exchange*	*Subsidiary*	*Adjustment*		*Consolidated*
	$A	*$FC*	*Rate*	*$A*	*DR*	*CR*	*$A*
Sales Revenue	990,000	448,850	1.80	807,930			1,797,930
Less: Cost of Sales							
Opening Inventory	71,000	–		–			71,000
Purchases	345,000	271,000	1.80	487,800			832,800
	416,000	271,000		487,800			903,800
Closing Inventory	55,000	87,000	1.95	169,650			224,650
	361,000	184,000		318,150			679,150
Gross Profit	629,000	264,850		489,780			1,118,780
Less: Expenses							
Administrative	34,000	62,000	1.80	111,600			145,600
Selling	45,000	80,038	1.80	144,068			189,068
Depreciation	125,404	12,557	W/S 1.2	21,347			146,751
Foreign Exchange Translation Loss	–	–	W/S 1.1	33,491			33,491
	204,404	154,595		310,506			$514,910
Net Profit Before Income Tax	424,596	110,255		179,274			603,870
Income Tax Expense	195,314	50,717	1.80	91,291			286,605
Net Profit	$229,282	$59,538		$87,983			$317,265
Translation of Retained Profits							
Retained Profits 1 July 20X0	445,718	-		-			445,718
Net Profit	229,282	59,538		87,983			317,265
Retained Profits 30 June 20X1	$675,000	$59,538		$87,983			$762,983

SCHEDULE 1 (cont.)

Introduction to Worksheets

Under the temporal method, foreign exchange gains or losses will arise in respect of monetary items. They will arise where exchange rates relevant to monetary items appearing in the previous year's statement of financial position change in the current year. They will also arise when exchange rates used in translating those elements of the statement of financial performance involving monetary items differ from the rates applied in the current year's statement of financial position in respect of those monetary items.

WORKSHEET 1.1 – Foreign Exchange Translation Loss

Subsidiary Ltd borrowed $FC200,000 on 30 June 20X0 when the exchange rate was $FC1.00 = $A1.70. The exchange rate at the end of the year, when the first instalment was paid, was $FC1.00 = $A2.00.

		$FC	*Rate*	*$A*
Loan	30 June 20X0	200,000	1.70	340,000
	30 June 20X1	200,000	2.00	400,000
(A) Loss on long-term monetary items				$60,000

Net monetary items other than long-term debt:

	$FC 20X0	*$FC 20X1*
Monetary Assets		
Cash	98,299	118,011*
Trade Debtors	–	45,000
Total Monetary Assets	98,299	163,011
Monetary Liabilities		
Trade Creditors	–	28,900
Provision for Income Tax	–	50,717
Total Monetary Liabilities	–	79,617
Net Monetary Assets	$98,299	$83,394

* includes loan instalment of $FC40,000 paid on 30 June 20X1

SCHEDULE 1 (cont.)

Gain from translating opening net monetary assets at the average rate (1.80) rather than the closing rate at 30 June 20X0 (1.70):

98,299 x 0.1 =	9,830

Gain from translating closing net monetary assets at the closing rate at 30 June 20X1 (2.00) rather than the average rate (1.80):

83,394 x 0.2 =	16,679

(B) Gain on short-term monetary items:

9,830 + 16,679 =	$26,509

(C) Net loss on translation of monetary items (A) – (B):

60,000 – 26,509 =	$33,491

SCHEDULE 1 (cont.)

WORKSHEET 1.2 – Depreciable Assets

	Cost $FC	*Depreciation Rate*	*Depreciation $FC*	*WDV $FC*
Asset $FC				
Buildings	110,040	0.05	5,502	104,538
Plant & Equipment	70,550	0.10	7,055	63,495
	$180,590		$12,557	$168,033

	Cost $FC	*Historical Exchange Rate*	*Cost $A*	*Depreciation Rate*	*Depreciation $A*	*WDV $A*
Asset $A						
Buildings	110,040	1.70	187,068	0.05	9,353	177,715
Plant & Equipment	70,550	1.70	119,935	0.10	11,994	107,941
	$180,590		$307,003		$21,347	$285,656

SCHEDULE 2 SELF-SUSTAINING FOREIGN OPERATION

Statements of Financial Position as at 30 June 20X1

	Investor	*Subsid.*	*Exchange*	*Subsid.*	*Adjustment*		*Consolidated*
	$A	*$FC*	*Rate*	*$A*	*DR*	*CR*	*$A*
Current Assets							
Cash at Bank	67,589	78,011	2.00	156,022			223,611
Trade Debtors	45,000	45,000	2.00	90,000			135,000
Inventories	55,000	87,000	2.00	174,000			229,000
Total Current Assets	167,589	210,011		420,022			587,611
Non-Current Assets							
Investment in Subsidiary	170,000	–		–		170,000	–
Land	330,314	21,111	2.00	42,222			372,536
Buildings	208,086	104,538	2.00	209,076			417,162
Plant & Equipment	1,150,000	63,495	2.00	126,990			1,276,990
Total Non-Current Assets	1,858,400	189,144		378,288			2,066,688
Total Assets	$2,025,989	$399,155		$798,310			$2,654,299
Current Liabilities							
Trade Creditors	5,675	28,900	2.00	57,800			63,475
Loan	–	40,000	2.00	80,000			80,000
Provision for Income Tax	195,314	50,717	2.00	101,434			296,748
Total Current Liabilities	200,989	119,617		239,234			440,223
Non-Current Liabilities							
Loan	300,000	120,000	2.00	240,000			540,000
Total Non-Current Liabilities	300,000	120,000		240,000			540,000
Total Liabilities	500,989	239,617		479,234			980,223
Net Assets	$1,525,000	$159,538		$319,076			$1,674,076
Equity							
Paid-up Capital	850,000	100,000	1.70	170,000	170,000		850,000
Foreign Currency Translation Reserve	–	–	W/S 2.1	28,858			28,858
Retained Profits	675,000	59,538	S of Fin Perf	120,218			795,218
Total Equity	$1,525,000	$159,538		$319,076			$1,674,076

SCHEDULE 2 (cont.)

Statements of Financial Performance for the year ended 30 June 20X1

	Investor *$A*	*Subsidiary* *$FC*	*Exchange* *Rate*	*Subsidiary* *$A*	*Adjustment* *DR*	*CR*	*Consolidated* *$A*
Sales Revenue	990,000	448,850	1.80	807,930			1,797,930
Less: Cost of Sales							
Opening Inventory	71,000	–		–			71,000
Purchases	345,000	271,000	1.80	487,800			832,800
	416,000	271,000		487,800			903,800
Closing Inventory	55,000	87,000	1.95	169,650			224,650
	361,000	184,000		318,150			679,150
Gross Profit	629,000	264,850		489,780			1,118,780
Less: Expenses							
Administrative	34,000	62,000	1.80	111,600			145,600
Selling	45,000	80,038	1.80	144,068			189,068
Depreciation	125,404	12,557	W/S 2.2	22,603			148,007
	204,404	154,595		278,271			482,675
Net Profit Before Income Tax	424,596	110,255		211,509			636,105
Income Tax Expense	195,314	50,717	1.80	91,291			286,605
Net Profit	$229,282	$59,538		$120,218			$349,500
Translation of Retained Profits							
Retained Profits 1 July 20X0	445,718	–		–			445,718
Net Profit	229,282	59,538		120,218			349,500
Retained Profits 30 June 20X1	$675,000	$59,538		$120,218			$795,218

SCHEDULE 2 (cont.)

SELF-SUSTAINING FOREIGN OPERATION

Introduction to Worksheets

Exchange differences arise under the current rate method whenever the exchange rate employed in translating the statement of financial position at the end of a year differs from that employed for the previous year's statement of financial position or from the rates employed in translating the current year's statement of financial performance.

WORKSHEET 2.1 – Movement in Foreign Currency Translation Reserve

	$FC	*Exchange Rate*	*$A*
Opening Net Assets	100,000	1.70	170,000
Change in Net Assets	59,538	S of Fin Perf	120,218
	159,538		290,218
Closing Net Assets	159,538	2.00	319,076
Exchange Gain			$28,858

WORKSHEET 2.2 – Depreciable Assets

Asset $FC	*Cost $FC*			*Depreciation Rate*	*Depreciation $FC*	*WDV $FC*
Buildings	110,040			0.05	5,502	104,538
Plant & Equipment	70,550			0.10	7,055	63,495
	$180,590				$12,557	$168,033

Asset $FC	*Cost $FC*	*Current Exchange Rate*	*Cost $A*	*Depreciation Rate*	*Depreciation $A*	*WDV $A*
Buildings	110,040	2.00	220,080	0.05	11,004	209,076
Plant & Equipment	70,550	2.00	141,100	0.10	14,110	126,990
	$180,590		$361,180		$25,114	$336,066

Note: The depreciation expense has been translated at the average rate (1.80) rather than at the closing rate (2.00).

APPENDIX 2

Accounting for Foreign Currency Contracts

This Appendix forms part of the commentary and is provided for illustrative purposes only. It illustrates the calculations underlying the reporting requirements in relation to a foreign currency contract.

Data

On 30 April 20X0, Importer Ltd purchased inventories costing $FC95,000 on trade credit. Payment was due in 3 months (i.e. on 31 July 20X0). At the time of purchase the following exchange rate (the spot rate) applied:

$FC1.00 = $A1.00

On 30 June 20X0, Importer Ltd's reporting date, the following spot rate applied:

$FC1.00 = $A1.10

On 31 July 20X0, when the creditor was paid for the goods, the spot rate had moved to:

$FC1.00 = $A1.12

Journal Entries for Purchase of Inventories

If the above purchase was made on an unhedged basis the following entries would be made:

		DR	CR
30 April 20X0	Inventories	95,000	
	Trade Creditor		95,000
	(Purchase of inventories costing $FC95,000 when the spot rate was $FC1.00 = $A1.00)		
30 June 20X0	Foreign Exchange Loss	9,500	
	Trade Creditor		9,500
	(Foreign exchange loss on trade credit outstanding when the spot rate moved from $FC1.00 = $A1.00 to $FC1.00 = $A1.10 which required the trade creditor to be remeasured from $A95,000 to $A104,500)		

31 July 20X0	Foreign Exchange Loss	1,900	
	Trade Creditor		1,900
	(Further foreign exchange loss on trade credit outstanding when the spot rate moved from $FC1.00 = $A1.10 to $FC1.00 = $A1.12)		
31 July 20X0	Trade Creditor	106,400	
	Cash at Bank		106,400
	(Payment of trade creditor when the exchange rate was $FC1.00 = $A1.12)		

HEDGE CONTRACT

Assume that Importer Ltd entered into a foreign currency contract to hedge the above specific commitment.

Further Data

On 31 March 20X0, Importer Ltd ordered the inventories and was given a firm price of $FC95,000 (when the spot rate was $FC1.00 = $A0.95). On the same date, in order to limit the exposure to exchange rate movements, Importer Ltd entered into a foreign currency contract (at a forward rate of $FC1.00 = $A0.97) for the purchase of $FC95,000 for delivery on 31 July 20X0.

Calculations

Cost of Entering Foreign Currency Hedge Contract

(a) At time of entry

- spot rate $FC1.00 = $A0.95
- forward rate $FC1.00 = $A0.97

(b) Number of units of foreign currency to be purchased

- $FC95,000

(c) Cost of contract

- $FC95,000 x (0.97 - 0.95) = $A1,900

Note: Under paragraph 6.5 this cost would be deferred and included in the cost of the related inventories.

Exchange Gains on Foreign Currency Hedge Contract Receivable

(a) At 30 April 20X0

- spot rate at 31 March 20X0 $FC1.00 = $A0.95
- spot rate at 30 April 20X0 $FC1.00 = $A1.00

(b) Gain on hedge contract receivable from 31 March 20X0 to 30 April 20X0

- $FC95,000 x (1.00 – 0.95) = $A4,750

Note: Under paragraph 6.5 this gain would form part of the net cost of the related inventories.

(c) At 30 June 20X0 the spot rate had moved to $FC1.00 = $A1.10

(d) Gain on hedge contract receivable from 30 April 20X0 to 30 June 20X0

- $FC95,000 x (1.10 – 1.00) = $A9,500

Note: Under paragraph 6.4 this gain on the foreign currency hedge contract receivable would be recognised as a revenue in net profit or loss/result. However, it would be offset by an equivalent loss on the underlying transaction (the purchase).

The trade creditor was recognised at 30 April 20X0 at $FC95,000 x 1.00 = $A95,000 and at 30 June 20X0 was restated to $FC95,000 x 1.10 = $A104,500 (yielding a loss of $A9,500).

(e) Gain on hedge contract receivable from 30 June 20X0 to 31 July 20X0

- $FC95,000 x (1.12 – 1.10) = $A1,900

Note: As for (d) above, this gain would be recognised as a revenue in net profit or loss/result and would be offset by an equivalent loss on the trade creditor of $A1,900.

Journal Entries for Hedge Contract

Journal entries incorporating the calculations for the hedge contract could be prepared as follows.

		DR	CR
31 Mar. 20X0	Hedge Contract Receivable	90,250	
	Cost of Entering Hedge Contract	1,900	
	Hedge Contract Payable		92,150
	(Recording hedge contract)		
30 April 20X0	Hedge Contract Receivable	4,750	
	Gain on Hedge Contract Receivable		4,750
	(Gain on hedge contract receivable up to date of recognition of inventories)		
30 April 20X0	Gain on Hedge Contract Receivable	4,750	
	Inventories		4,750
	(Transfer to inventories account on recognition of inventories)		
30 April 20X0	Inventories	1,900	
	Cost of Entering Hedge Contract		1,900
	(Transfer to inventories account on recognition of inventories)		
30 June 20X0	Hedge Contract Receivable	9,500	
	Foreign Exchange Gain		9,500
	(Foreign exchange gain on hedge contract receivable offsetting equivalent loss on trade creditor)		
31 July 20X0	Hedge Contract Receivable	1,900	
	Foreign Exchange Gain		1,900
	(Further foreign exchange gain on hedge contract receivable offsetting equivalent loss on trade creditor)		

SUMMARY

(a) Unhedged Purchase

- Inventories recognised at $A95,000 ($FC95,000 x 1.00)
- Total foreign exchange loss (statement of financial performance) amounted to $A11,400 (9,500 + 1,900).

(b) Hedged Purchase

- Inventories recognised at $A92,150 comprising:

Cost of inventories	$A 95,000
Cost of entering the hedge contract	$A 1,900
Gain on contract to 30 April 20X0	$A (4,750)
Net cost of inventories	$A 92,150

Commentary

It should be noted that, for the hedged purchase, the cost arising at the time of entering into the foreign currency hedge contract (that is, resulting from the premium of $A0.02) and the gain arising on the hedge contract receivable up until the purchase were included in the measurement of the cost of the inventories.

Subsequently the foreign currency hedge contract receivable was hedging a foreign currency liability. Gains on the hedge contract receivable offset losses on the trade creditor.

Hedging Net Exposure

If the foreign currency hedge contract illustrated above had been for hedging a net foreign currency exposure, the only difference in accounting for the contract would have been that the gain derived prior to the acquisition of the inventories, and the cost arising at the time of entering into the contract, would have been recognised as revenues and expenses. The gain would have been recognised immediately and the cost would have been amortised over the four-month life of the foreign currency hedge contract.

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with International Accounting Standard IAS 21 "The Effects of Changes in Foreign Exchange Rates" except that IAS 21:

(a) applies to foreign currency contracts not classified as hedges, although International Accounting Standard IAS 39 "Financial Instruments: Recognition and Measurement" may be applied to those contracts; and

(b) requires that on disposal, or part disposal, of a foreign operation the balance in the foreign currency translation reserve relating to the disposal be recycled as a revenue or an expense in net profit or loss/result in the reporting period in which the disposal is recognised.

Conformity with New Zealand Accounting Standards

As at the date of issue of this Standard, compliance with this Standard and relevant requirements of Accounting Standard AASB 1026 and Australian Accounting Standard AAS 28 "Statement of Cash Flows" will ensure conformity with Financial Reporting Standard FRS-21 "Accounting for the Effects of Changes in Foreign Currency Exchange Rates" and paragraphs 5.3, 5.5, 5.6, 5.8 and 5.13(d) of Statement of Standard Accounting Practice SSAP-21 "Accounting for the Effects of Changes in Foreign Currency Exchange Rates" except that:

(a) FRS-21 applies to foreign currency contracts that are not classified as hedges and requires short-term transactions covered by forward exchange contracts to be translated at the market rates specified in the forward exchange contracts;

(b) FRS-21 has no separate requirements for exchange gains and losses that are directly attributable to the acquisition, construction or production of qualifying assets. Therefore, FRS-21 implicitly requires such exchange gains and losses to be recognised as revenues and expenses in the reporting period in which they arise; and

(c) paragraph 5.8 of SSAP-21 requires that if a future income or expense stream is designated as a hedge of a foreign currency liability or asset, or vice versa, then the liability or asset should be translated at the spot rate current at the reporting date and the resulting exchange difference should be deferred and amortised over the period of the hedge.

BACKGROUND TO REVISION

This section does not form part of the Standard. It is a summary of the reasons for the current revision to the Standard.

1 The reissue of the Standard is part of a program commenced by the former Australian Accounting Standards Board and the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation (the former Boards) to achieve greater harmony between Australian accounting standards and those of the International Accounting Standards Committee. The reconstituted Australian Accounting Standards Board (AASB) is continuing this program and has issued the Standard as part of a single series of Standards, rather than in the former two series as both an Accounting Standard and an Australian Accounting Standard.

2 The reissue of the Standard (hereafter referred to as the revised Standard) follows consideration of the responses received on:

(a) Exposure Draft ED 86 "Foreign Currency Translation" which was prepared by the former Boards and released in December 1997. ED 86 contained proposals aimed at harmonising Accounting Standard AASB 1012 and Australian Accounting Standard AAS 20 "Foreign Currency Translation" with International Accounting Standard IAS 21 "The Effects of Changes in Foreign Exchange Rates"; and

(b) Invitation to Comment "Application of Foreign Currency Translation to Equity" which was prepared by the former Boards and released in November 1998. The Invitation to Comment canvassed views on the translation of items of equity denominated in a foreign currency which emerged as an issue following amendments to the Corporations Law effective 1 July 1998.

3 In regard to accounting for hedging transactions, neither ED 86 nor the Invitation to Comment proposed changes other than clarifications of the existing requirements. IAS 21 only addresses hedging transactions to the extent that the hedging transaction hedges the entity's net investment in a foreign operation. The AASB decided to retain the existing requirements despite doubts as to their conceptual soundness. The AASB expects to review the requirements relating to hedging transactions when the project on the recognition and measurement of financial instruments is further advanced.

Principal Changes from the Previous Standard

4 As a result of the proposals contained in ED 86 and the Invitation to Comment, and the comments made by respondents, the revised Standard:

(a) incorporates requirements for the translation of items of equity denominated in a foreign currency;

(b) requires that the tax effect of exchange differences relating to monetary items forming part of the net investment in a self-sustaining foreign operation, and hedges of those monetary items, be taken to the foreign currency translation reserve on incorporation into the entity's financial report;

(c) incorporates requirements for the disclosure by the entity of a change in reporting currency by a foreign operation;

(d) incorporates requirements for the restatement of the financial reports of a foreign operation that reports to the parent entity in the currency of a hyperinflationary economy before the translation of those financial reports, together with disclosures relating to the restatement;

(e) requires that, on disposal or part disposal of a foreign operation, any balance in the foreign currency translation reserve relating to that operation be transferred to retained profits (surplus) or accumulated losses (deficiency) in the reporting period in which the disposal, or part disposal, is recognised;

(f) incorporates the provisions of Urgent Issues Group Abstract 15 "Early Termination of Foreign Currency Hedges"; and

(g) clarifies the requirements relating to foreign currency hedging transactions.

Noteworthy Differences from ED 86

5 The revised Standard retains the basic structure and content of ED 86 except that:

(a) ED 86 proposed that all foreign currency contracts including those relating to speculative dealing be accounted for in the same manner as other foreign currency contracts, that is, monetary items arising under foreign currency contracts should be translated on the basis of spot rates at transaction date and reporting dates. The revised Standard only applies to foreign currency contracts classified as hedges. The AASB understands that where there is a conflict between IAS 21 and International Accounting Standard IAS 39 "Financial Instruments: Recognition and Measurement", it is intended that IAS 39 should take precedence. IAS 39 requires foreign currency contracts not classified as hedges to be recognised at fair value. It follows that foreign currency contracts not classified as hedges and measured at fair value in the reporting currency would not require translation under IAS 21. The AASB will address the measurement and recognition of foreign currency contracts in its project on financial instruments;

(b) requirements for the translation of items of equity denominated in a foreign currency have been incorporated in the revised Standard. ED 86 and the superseded Standard were silent as to the translation of items of equity denominated in a foreign currency. For completeness of coverage, the revised Standard includes requirements for the translation of items of equity;

(c) ED 86 proposed that the balance in the foreign currency translation reserve on the disposal or part disposal of a foreign operation be recognised as a revenue or an expense in the reporting period in which the disposal of the foreign operation is recognised. The revised Standard requires that the same balance be transferred to retained profits (surplus) or accumulated losses (deficiency) in the reporting period in which the disposal is recognised. The proposals in ED 86 were developed in the interests of harmonisation. However, it was noted in ED 86 that this requirement of IAS 21 conflicts with the requirements of Accounting Standard AASB 1018 and Australian Accounting Standard AAS 1 "Statement of Financial Performance", Accounting Standard AASB 1024 "Consolidated Accounts" and Australian Accounting Standard AAS 24 "Consolidated Financial Reports". AASB 1024 and AAS 24 require the gain or loss on disposal of a controlled entity to be calculated by comparing the proceeds of disposal with the aggregate of the cost of the investment and post-acquisition changes in reserves. AASB 1018 and AAS 1 do not permit transfers from reserves to be recycled as revenues or expenses. In addition, the requirement in IAS 21 is inconsistent with the treatment of the asset revaluation reserve on disposal of a revalued non-current asset contained in International Accounting Standard IAS 16 “Property, Plant and Equipment”. Respondents to ED 86 were divided as to whether they preferred the proposal in ED 86, which conformed with IAS 21, or consistency with the principles embodied in AASB 1018, AAS 1, AASB 1024, AAS 24 and IAS 16. The AASB decided to retain consistency with the existing body of Accounting Standards;

(d) ED 86 implied that the financial report prepared by a foreign operation could be prepared at a different reporting date from the reporting date of the entity. This provision differs from the requirement in AASB 1024 and AAS 24 that the consolidated financial report is presented for the same reporting period as that of the parent entity’s financial report, and that the preparation of an interim report in respect of a subsidiary may be necessary where the reporting dates differ. The revised Standard is consistent with AASB 1024 and AAS 24;

(e) requirements for the disclosure by the entity of a change in reporting currency by a foreign operation have been incorporated in the revised Standard. ED 86 and the superseded Standard were silent on this issue; and

(f) the provisions of Urgent Issues Group Abstract 15 “Early Termination of Foreign Currency Hedges”, issued in November 1997, have been incorporated in the revised Standard.