

ACCOUNTING STANDARD

AASB 121

July 2004

The Effects of Changes in Foreign Exchange Rates



Australian Government

**Australian Accounting
Standards Board**

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ISSN 1036-4803

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BASIS FOR CONCLUSIONS ON IAS 21

(available to AASB online subscribers or through the IASB)

Australian Accounting Standard AASB 121 *The Effect of Changes in Foreign Exchange Rates* is set out in paragraphs 1 – 57. All the paragraphs have equal authority. Terms defined in this Standard are in *italics* the first time they appear in the Standard. AASB 121 is to be read in the context of other Australian Accounting Standards, including AASB 1048 *Interpretation and Application of Standards*, which identifies the UIG Interpretations. In the absence of explicit guidance, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies.

PREFACE

Reasons for Issuing AASB 121

The Australian Accounting Standards Board (AASB) is implementing the Financial Reporting Council's policy of adopting the Standards of the International Accounting Standards Board (IASB) for application to reporting periods beginning on or after 1 January 2005. The AASB has decided it will continue to issue sector-neutral Standards, that is, Standards applicable to both for-profit and not-for-profit entities, including public sector entities. Except for Standards that are specific to the not-for-profit or public sectors or that are of a purely domestic nature, the AASB is using the IASB Standards as the "foundation" Standards to which it adds material detailing the scope and applicability of a Standard in the Australian environment. Additions are made, where necessary, to broaden the content to cover sectors not addressed by an IASB Standard and domestic, regulatory or other issues.

The IASB defines International Financial Reporting Standards (IFRSs) as comprising:

- (a) International Financial Reporting Standards;
- (b) International Accounting Standards; and
- (c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

The Australian equivalents to IFRSs are:

- (a) Accounting Standards issued by the AASB that are equivalent to Standards issued by the IASB, being AASBs 1 – 99 corresponding to the IFRS series and AASBs 101 – 199 corresponding to the IAS series; and
- (b) UIG Interpretations issued by the AASB corresponding to the Interpretations adopted by the IASB, as listed in AASB 1048 *Interpretation and Application of Standards*.

Main Features of this Standard

Application Date

This Standard is applicable to annual reporting periods beginning on or after 1 January 2005. To promote comparability among the financial reports of Australian entities, early adoption of this Standard is not permitted.

First-time Application and Comparatives

Application of this Standard will begin in the first annual reporting period beginning on or after 1 January 2005 in the context of adopting all Australian equivalents to IFRSs. The requirements of AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards*, the Australian equivalent of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, must be observed. AASB 1 requires prior period information, presented as comparative information, to be restated as if the requirements of this Standard had always applied. This differs from previous Australian requirements where changes in accounting policies did not require the restatement of the income statement and balance sheet of the preceding period.

Main Requirements

This Standard applies to all foreign currency transactions, with the exception of those transactions within the scope of AASB 139 *Financial Instruments: Recognition and Measurement*, and specifies the method an entity uses to translate its operations from its functional currency to its presentation currency, including translations undertaken for the purpose of consolidation. The Standard requires:

- (a) foreign currency transactions to be recorded, on initial recognition, in the entity's functional currency by applying the exchange rate at the date of the transaction;
- (b) monetary items to be translated at subsequent reporting dates by applying the closing rate, with exchange differences recognised as income or expense for the period;
- (c) non-monetary items to be translated at subsequent reporting dates by applying the rate at the date of the transaction or revaluation, with exchange differences arising on non-monetary items being recognised in the same way as the related gain or loss on the non-monetary item;
- (d) each entity to determine its functional currency and measure its results and financial position in that currency;

- (e) an entity to select a presentation currency or currencies that may or may not be its functional currency;
- (f) an entity to translate its financial report to the presentation currency if the entity's presentation currency is different from its functional currency. The entity must translate assets and liabilities at the closing rate, and income and expense items at the rate that applied at the date of each transaction. Exchange differences are recognised as a separate component of equity; and
- (g) where an entity uses a presentation currency that is not the Australian currency, that the entity disclose the reason and justification for the choice of presentation currency.

Differences between this Standard and AASB 1012

AASB 121 adopts a fundamentally different approach to accounting for the effects of changes in foreign exchange rates from the AASB Standard that it supersedes, AASB 1012 *Foreign Currency Translation*.

In AASB 121, the notion of reporting currency (which is used in AASB 1012) is replaced by two concepts: functional currency (the currency in which the entity measures the items in its financial report) and presentation currency (the currency in which the entity presents its financial report). Each entity (whether a stand-alone entity; a parent of a group; or an operation within a group, such as a subsidiary) is required to determine its functional currency and measure its results and financial position in that currency. The entity does not have a free choice of functional currency.

Each entity (whether a group or stand-alone entity) is permitted to present its financial report in any currency (or currencies) that it chooses, whereas AASB 1034 *Financial Report Presentation and Disclosures* requires entities to present their financial reports in Australian currency. AASB 121 prescribes the method an entity must use to translate the items in its financial report from the entity's functional currency to its presentation currency or currencies.

A more detailed description of the differences between this Standard and AASB 1012 accompanies this Standard under the heading "Differences between AASB 121 and AASB 1012".

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

AASB 121 and IAS 21

AASB 121 is equivalent to IAS 21 *The Effects of Changes in Foreign Exchange Rates* issued by the IASB. Paragraphs that have been added to this Standard (and do not appear in the text of the equivalent IASB Standard) are identified with the prefix “Aus”, followed by the number of the relevant IASB paragraph and decimal numbering.

Compliance with IAS 21

Entities that comply with AASB 121 will simultaneously be in compliance with IAS 21.

AASB 121 and IPSAS 4

International Public Sector Accounting Standards (IPSASs) are issued by the Public Sector Committee of the International Federation of Accountants.

IPSAS 4 *The Effects of Changes in Foreign Exchange Rates* (May 2000) is drawn primarily from the 1993 version of IAS 21. As AASB 121 corresponds to a more recent version of IAS 21, which takes a fundamentally different approach from that adopted by both the previous version of IAS 21 and IPSAS 4, a comparison is not provided.

ACCOUNTING STANDARD AASB 121

The Australian Accounting Standards Board makes Accounting Standard AASB 121 *The Effects of Changes in Foreign Exchange Rates* under section 334 of the *Corporations Act 2001*.

Dated 15 July 2004

D.G. Boymal
Chair – AASB

ACCOUNTING STANDARD AASB 121

THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Objective

1. An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have *foreign operations*. In addition, an entity may present its financial report in a *foreign currency*. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial report of an entity and how to translate the financial report into a *presentation currency*.
2. The principal issues are which *exchange rate(s)* to use and how to report the effects of changes in exchange rates in the financial report.

Application

Aus2.1 This Standard applies to:

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

Aus2.2 This Standard applies to annual reporting periods beginning on or after 1 January 2005.

- Aus2.3** This Standard shall not be applied to annual reporting periods beginning before 1 January 2005.
- Aus2.4** The requirements specified in this Standard apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.
- Aus2.5** When applicable, this Standard supersedes AASB 1012 *Foreign Currency Translation* as notified in the *Commonwealth of Australia Gazette* No S 586, 17 November 2000.
- Aus2.6** AASB 1012 remains applicable until superseded by this Standard.
- Aus2.7** Notice of this Standard was published in the *Commonwealth of Australia Gazette* No S 294, 22 July 2004.

Scope

- 3. This Standard shall be applied:¹**
- (a) in accounting for transactions and balances in foreign currencies, except for those derivatives transactions and balances that are within the scope of AASB 139 *Financial Instruments: Recognition and Measurement*;**
 - (b) in translating the results and financial position of foreign operations that are included in the financial report of the entity by consolidation or the equity method; and**
 - (c) in translating an entity's results and financial position into a presentation currency.**
4. AASB 139 applies to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of AASB 139 (e.g. some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its *functional currency* to its presentation currency.

¹ See also UIG Interpretation 107 *Introduction of the Euro*, as identified in AASB 1048 *Interpretation and Application of Standards*.

5. This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. AASB 139 applies to hedge accounting.
6. This Standard applies to the presentation of an entity's financial report in a foreign currency and sets out requirements for the resulting financial report to be described as complying with Australian equivalents to IFRSs. For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.
7. This Standard does not apply to the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (see AASB 107 *Cash Flow Statements*).

Definitions

8. **The following terms are used in this Standard with the meanings specified.**

Closing rate is the spot exchange rate at the reporting date.

Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

Exchange rate is the ratio of exchange for two currencies.

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

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

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

Functional currency is the currency of the primary economic environment in which the entity operates.

A group is a parent and all its subsidiaries.

***Monetary items* are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.**

***Net investment in a foreign operation* is the amount of the reporting entity's interest in the net assets of that operation.**

***Presentation currency* is the currency in which the financial report is presented.**

***Spot exchange rate* is the exchange rate for immediate delivery.**

Elaboration on the Definitions

Functional Currency

9. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors in determining its functional currency:
 - (a) the currency:
 - (i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and
 - (ii) of the country whose competitive forces and regulations mainly determine the sales price of its goods and services;
 - (b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).
10. The following factors may also provide evidence of an entity's functional currency:
 - (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated;
 - (b) the currency in which receipts from operating activities are usually retained.
11. The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity,

in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint venture):

- (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other *monetary items*, incurs expenses, generates income and arranges borrowings, all substantially in its local currency;
 - (b) whether transactions with the reporting entity are a high or low proportion of the foreign operation's activities;
 - (c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it;
 - (d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.
12. When the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 9 before considering the indicators in paragraphs 10 and 11, which are designed to provide additional supporting evidence to determine an entity's functional currency.
13. An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.
14. If the functional currency is the currency of a hyperinflationary economy, the entity's financial report is restated in accordance with AASB 129 *Financial Reporting in Hyperinflationary Economies*. An entity cannot avoid restatement in accordance with AASB 129 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its parent).

Net Investment in a Foreign Operation

15. An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 32 and 33. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Monetary Items

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

Summary of the Approach Required by this Standard

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

reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 38-50.

19. This Standard also permits a stand-alone entity preparing financial statements or an entity preparing separate financial statements in accordance with AASB 127 *Consolidated and Separate Financial Statements* to present its financial statements in any currency (or currencies). If the entity's presentation currency differs from its functional currency, its results and financial position are also translated into the presentation currency in accordance with paragraphs 38-50.

Reporting Foreign Currency Transactions in the Functional Currency

Initial Recognition

20. A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:
- (a) buys or sells goods or services whose price is denominated in a foreign currency;
 - (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
 - (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
21. **A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the *spot exchange rate* between the functional currency and the foreign currency at the date of the transaction.**
22. The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with Australian equivalents to IFRSs. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Reporting at Subsequent Reporting Dates

23. At each reporting date:
- (a) **foreign currency monetary items shall be translated using the closing rate;**
 - (b) **non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and**
 - (c) **non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined.**
24. The carrying amount of an item is determined in conjunction with other relevant Standards. For example, property, plant and equipment may be measured in terms of fair value or historical cost in accordance with AASB 116 *Property, Plant and Equipment*. Whether the carrying amount is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this Standard.
25. The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories is the lower of cost and net realisable value in accordance with AASB 102 *Inventories*. Similarly, in accordance with AASB 136 *Impairment of Assets*, the carrying amount of an asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable amount. When such an asset is non-monetary and is measured in a foreign currency, the carrying amount is determined by comparing:
- (a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (i.e. the rate at the date of the transaction for an item measured in terms of historical cost); and
 - (b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date when that value was determined (e.g. the closing rate at the reporting date).

The effect of this comparison may be that an impairment loss is recognised in the functional currency but would not be recognised in the foreign currency, or vice versa.

26. When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

Recognition of Exchange Differences

27. As noted in paragraph 3, AASB 139 applies to hedge accounting for foreign currency items. The application of hedge accounting requires an entity to account for some *exchange differences* differently from the treatment of exchange differences required by this Standard. For example, AASB 139 requires that exchange differences on monetary items that qualify as hedging instruments in a cash flow hedge are reported initially in equity to the extent the hedge is effective.
- 28. Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in a previous financial report, shall be recognised in profit or loss in the period in which they arise, except as described in paragraph 32.**
29. When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same reporting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent reporting period, the exchange difference recognised in each period up to the date of settlement is determined by the change in exchange rates during each period.
- 30. When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss shall be recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.**
31. Other Australian Accounting Standards require some gains and losses to be recognised directly in equity. For example, AASB 116 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognised directly in equity. When such an asset is measured in a foreign currency, paragraph 23(c) of this Standard requires the revalued amount to be translated using the rate at the date

the value is determined, resulting in an exchange difference that is also recognised in equity.

- 32. Exchange differences arising on a monetary item that forms part of a reporting entity's *net investment in a foreign operation* (see paragraph 15) shall be recognised in profit or loss in the separate financial report of the reporting entity or the individual financial report of the foreign operation as appropriate. In the financial report that includes the foreign operation and the reporting entity (e.g. the consolidated financial report when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in a separate component of equity and recognised in profit or loss on disposal of the net investment in accordance with paragraph 48.**
33. When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 28. Similarly, if such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements in accordance with paragraph 28. Such exchange differences are reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (i.e. the financial statements in which the foreign operation are consolidated or accounted for using the equity method). However, a monetary item that forms part of the reporting entity's net investment in a foreign operation may be denominated in a currency other than the functional currency of either the reporting entity or the foreign operation. The exchange differences that arise on translating the monetary item into the functional currencies of the reporting entity and the foreign operation are not reclassified to the separate component of equity in the financial report that includes the foreign operation and the reporting entity (i.e. they remain recognised in profit or loss).
34. When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial report, all amounts are translated into the functional currency in accordance with paragraphs 20-26. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate, and non-monetary items that are measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition.

Change in Functional Currency

- 35. When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.**
36. As noted in paragraph 13, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.
37. The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously classified in equity in accordance with paragraphs 32 and 39(c) are not recognised in profit or loss until the disposal of the operation.

Use of a Presentation Currency other than the Functional Currency

Translation to the Presentation Currency

38. An entity may present its financial report in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that the consolidated financial statements may be presented.
- 39. The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**
- (a) **assets and liabilities for each balance sheet presented (i.e. including comparatives) shall be translated at the closing rate at the date of that balance sheet;**

- (b) **income and expenses for each income statement (i.e. including comparatives) shall be translated at exchange rates at the dates of the transactions; and**
 - (c) **all resulting exchange differences shall be recognised as a separate component of equity.**
- 40. For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
- 41. The exchange differences referred to in paragraph 39(c) result from:
 - (a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences arise both on income and expense items recognised in profit or loss and on those recognised directly in equity;
 - (b) translating the opening net assets at a closing rate that differs from the previous closing rate.

These exchange differences are not recognised in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and recognised as part of, minority interest in the consolidated balance sheet.

- 42. **The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**
 - (a) **all amounts (i.e. assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent balance sheet, except that**
 - (b) **when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial report (i.e. not adjusted for**

subsequent changes in the price level or subsequent changes in exchange rates).

43. **When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with AASB 129 before applying the translation method set out in paragraph 42, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy (see paragraph 42(b)). When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements in accordance with AASB 129, it shall use as the historical costs for translation into the presentation currency the amounts restated to the price level at the date the entity ceased restating its financial statements.**

Translation of a Foreign Operation

44. Paragraphs 45-47, in addition to paragraphs 38-43, apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation or the equity method.
45. The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see AASB 127 and AASB 131 *Interests in Joint Ventures*). However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference continues to be recognised in profit or loss or, if it arises from the circumstances described in paragraph 32, it is classified as equity until the disposal of the foreign operation.
46. When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity's financial statements. When this is not done, AASB 127 allows the use of a different reporting date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates. In such a case, the assets and liabilities of the foreign

operation are translated at the exchange rate at the reporting date of the foreign operation. Adjustments are made for significant changes in exchange rates up to the reporting date of the reporting entity in accordance with AASB 127. The same approach is used in applying the equity method to associates and joint ventures in accordance with AASB 128 *Investments in Associates* and AASB 131.

- 47. Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 39 and 42.**

Disposal of a Foreign Operation

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

Tax Effects of All Exchange Differences

50. Gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency may have tax effects. AASB 112 *Income Taxes* applies to these tax effects.

Disclosure

- 51. In paragraphs 53 and 55-57 references to ‘functional currency’ apply, in the case of a group, to the functional currency of the parent.**

52. An entity shall disclose:
- (a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with AASB 139; and
 - (b) net exchange differences classified in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
53. When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.
- Aus53.1** When the presentation currency is different from the Australian currency, the entity shall disclose the reason and justification for not using the Australian currency.
54. When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.
55. When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with Australian equivalents to IFRSs only if they comply with all the requirements of each applicable Standard and each applicable Interpretation of those Standards including the translation method set out in paragraphs 39 and 42.
56. An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 55. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with Australian equivalents to IFRSs and the disclosures set out in paragraph 57 are required.
57. When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 55 are not met, it shall:

- (a) clearly identify the information as supplementary information to distinguish it from the information that complies with Australian equivalents to IFRSs;
- (b) disclose the currency in which the supplementary information is displayed; and
- (c) disclose the entity's functional currency and the method of translation used to determine the supplementary information.

Effective Date of IAS 21

58. [Deleted by the AASB]

Transition

59. [Deleted by the AASB]

60. [Deleted by the AASB]

Withdrawal of Other Pronouncements of the IASB

61. [Deleted by the AASB]

62. [Deleted by the AASB]

DIFFERENCES BETWEEN AASB 121 AND AASB 1012

This analysis of differences accompanies, but is not part of, AASB 121.

This section identifies the differences resulting from the replacement of AASB 1012 *Foreign Currency Translation* by AASB 121 *The Effects of Changes in Foreign Exchange Rates*. Because of the fundamental differences between AASB 1012 and AASB 121, the analysis of differences only examines the incompatibilities between the two Standards.

The analysis of differences should not be taken as providing an exhaustive list of differences.

Introduction

The existing approach to accounting for foreign currency transactions and operations prescribed by AASB 1012 assumes that the reporting currency is a single currency. AASB 1034 *Financial Report Presentation and Disclosures* requires entities covered by that Standard to use the Australian currency as the reporting currency.

AASB 121 follows a different approach. The notion of reporting currency (which is used in AASB 1012) is replaced by two concepts: functional currency (the currency in which the entity measures the items in its financial report) and presentation currency (the currency in which the entity presents its financial report). Each entity (whether a stand-alone entity; a parent of a group; or an operation within a group, such as a subsidiary) is required to determine its functional currency and measure its results and financial position in that currency. The entity determines its functional currency, as the currency “of the primary economic environment in which the entity operates” (see AASB 121.8).

Under AASB 121 entities can select one or more presentation currencies. Entities in a group with functional currencies different from the group’s presentation currency need to translate their results to the group’s presentation currency for the purpose of preparing consolidated financial statements. Overseas operations with the same functional currency as the parent, assuming the group financial statements are presented in the parent’s functional currency, require no translation because their results are prepared in the parent’s functional currency.

Differences

A. Incompatibilities between AASB 121 and AASB 1012, and other related pronouncements

A.1 Hedging

AASB 1012 prescribes the treatment for hedging transactions. AASB 121 does not deal with hedge accounting. Foreign currency hedge accounting is dealt with in AASB 139 *Financial Instruments: Recognition and Measurement*.

A.2 Classification of Foreign Operations

AASB 1012 looks to the relationship between the foreign operation and the reporting entity to determine the method of translating the foreign operation's financial information. An integrated foreign operation's results are translated using the temporal method and a self-sustaining foreign operation's results are translated using the current rate method. AASB 1012 requires that exchange differences be recognised as income or expense under the temporal method, or directly in equity under the current rate method.

AASB 121 does not distinguish between foreign operations that are integral and those that are self-sustaining. Instead, each entity must identify its functional currency in accordance with the Standard. The general translation provisions (AASB 121.38-43) prescribe the translation process from functional to presentation currency, with additional requirements (AASB 121.44-47) applicable for consolidation.

A.3 Self-Sustaining Foreign Operations

In general, those entities that were classified as self-sustaining under AASB 1012 will have a different functional currency from their Australian parent and will have to prepare their financial statements in that currency. On consolidation, the financial statements will be translated from the entity's functional currency to the group's presentation currency.

AASB 1012 specifies the current rate method for translating foreign operations that are classified as self-sustaining. This method bears closest resemblance to the requirements for translation from an entity's functional currency to its presentation currency under AASB 121.

The translation provisions in AASB 121 differ from the current rate method in AASB 1012 with respect to the translation of equity. In AASB 1012, equity items must be translated at the date of investment or acquisition. Post acquisition changes in equity are required to be translated on the date of the

movement. In contrast, AASB 121 does not specify the rate at which equity items should be translated.

Both Standards require that any exchange differences be recognised as a separate component of equity. AASB 1012 specifies that this account be called the “Foreign Currency Translation Reserve”. AASB 121 does not specify the name of the separate equity account.

A.4 Integrated Foreign Operations

AASB 1012 specifies the temporal method for translating foreign operations that are classified as integrated. AASB 121 does not incorporate the notion of integrated foreign operations, and does not allow the temporal translation method to be used.

A.5 Change of Reporting Currency

Under AASB 1012.7.8, a change in reporting currency of a foreign operation is recognised and disclosed as a change in accounting policy. AASB 1001 *Accounting Policies* has extensive disclosure and recognition requirements relating to changes in accounting policy. AASB 121.54, requires the disclosure of an explanation of a change in functional currency. AASB 121.53 requires disclosure of the reason for choosing a presentation currency that is different from the entity’s functional currency and AASB 121.Aus53.1 requires disclosure of the reason and the justification for using a presentation currency that is not the Australian currency.

A.6 Disposal of a Foreign Operation

On disposal of a self-sustaining foreign operation, AASB 1012.7.10 requires that the residual amount in the foreign currency translation reserve be offset against retained earnings/accumulated losses without being recognised in the income statement. AASB 121.48 prescribes that the balance in the translation reserve be recognised in the income statement on disposal of a foreign operation.