

Urgent Issues Group

Interpretation 107

July 2004

Introduction of the Euro



Australian Government

**Australian Accounting
Standards Board**

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PREFACE

Reasons for Issuing UIG Interpretation 107

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 same approach applies to UIG pronouncements. This Interpretation is part of the set of Australian equivalents to each International Accounting Standard (IAS), International Financial Reporting Standard (IFRS) and Interpretation of the IASB (collectively defined by the IASB as IFRSs). This set includes UIG Interpretations that correspond to the IASB Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

Main Features of this Interpretation

This Interpretation 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 Interpretation is not permitted.

Application of this Interpretation 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 Accounting Standard 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 Interpretation 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.

The Interpretation states that the changeover from national currencies of participating Member States of the European Union to the euro does not

change the accounting policies to be applied under AASB 121 *The Effects of Changes in Foreign Exchange Rates*.

Comparison with Superseded Requirements

There is no substantive difference with the superseded requirements in Australia. Accounting Standard AASB 1012 *Foreign Currency Translation*, now superseded by AASB 121, stated that a change to a regional currency at a fixed exchange rate (such as that arising from the introduction of the euro) is not a change in an accounting policy.

COMPARISON WITH INTERNATIONAL PRONOUNCEMENTS

UIG Interpretation 107 is equivalent to Standing Interpretations Committee Interpretation SIC-7 *Introduction of the Euro*, issued by the IASB.

Paragraphs that have been added to this Interpretation (and do not appear in the text of the equivalent SIC Interpretation) are identified with the prefix “Aus”, followed by the number of the relevant SIC paragraph and decimal numbering.

Entities that comply with Interpretation 107 will simultaneously be in compliance with SIC-7.

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 and does not specifically address a change to a regional currency.

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ISSUE

1. From 1 January 1999, the effective start of Economic and Monetary Union (EMU), the euro will become a currency in its own right and the conversion rates between the euro and the participating national currencies will be irrevocably fixed, that is the risk of subsequent exchange differences related to these currencies is eliminated from this date on.
2. The issue is the application of Accounting Standard AASB 121 *The Effects of Changes in Foreign Exchange Rates* to the changeover from the national currencies of participating Member States of the European Union to the euro ("the changeover").

CONSENSUS

3. **The requirements of AASB 121 regarding the translation of foreign currency transactions and financial reports of foreign operations shall be strictly applied to the changeover. The same rationale applies to the fixing of exchange rates when countries join EMU at later stages.**
4. **This means that, in particular:**
 - (a) **foreign currency monetary assets and liabilities resulting from transactions shall continue to be translated into the functional currency at the closing rate. Any resultant exchange differences shall be recognised as income or expense immediately, except that an entity shall continue to apply its existing accounting policy for exchange gains and losses related to hedges of the currency risk of a forecast transaction;**
 - (b) **cumulative exchange differences relating to the translation of financial statements of foreign operations shall continue to be classified as equity and shall be recognised as income or expense only on the disposal of the net investment in the foreign operation; and**

- (c) **exchange differences resulting from the translation of liabilities denominated in participating currencies shall not be included in the carrying amount of related assets.**

Application

- Aus4.1 This Interpretation applies when AASB 121 applies.**
- Aus4.2 This Interpretation applies to annual reporting periods beginning on or after 1 January 2005.**
- Aus4.3 This Interpretation shall not be applied to annual reporting periods beginning before 1 January 2005.**
- Aus4.4 The requirements specified in this Interpretation apply to the financial report where information resulting from their application is material in accordance with AASB 1031 *Materiality*.**

DISCUSSION

- 5. AASB 121.23(a) requires that foreign currency monetary items (as defined by AASB 121.8) be reported using the closing rate at each reporting date. According to AASB 121.28, exchange differences arising from the translation of monetary items generally should be recognised as income or as expenses in the period in which they arise. The effective start of the EMU after the reporting date does not change the application of these requirements at the reporting date; in accordance with AASB 110 *Events after the Balance Sheet Date*, paragraph 10, it is not relevant whether or not the closing rate can fluctuate after the reporting date.
- 6. AASB 121.5 states that the Standard does not apply to hedge accounting. Therefore, this Interpretation does not address how foreign currency hedges should be accounted for. AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* would allow such a change in accounting policy only if the change would result in a more appropriate presentation of events or transactions.¹ The effective start of EMU, of itself, does not justify a change to an entity's established accounting policy related to hedges of forecast transactions because the changeover does not affect the economic rationale of such hedges. Therefore, the changeover should not alter the accounting policy where gains and losses on financial

¹ The accounting for hedges is now covered under AASB 139 *Financial Instruments: Recognition and Measurement*.

instruments used as hedges of forecast transactions are initially recognised in equity and matched with the related income or expense in a future period.

7. AASB 121.48 requires the cumulative amount of exchange differences relating to the translation of the financial statements of a foreign operation which have been deferred in equity in accordance with AASB 121.32 or 121.39(c) to be recognised as income or expenses in the same period in which the gain or loss on disposal of the foreign operation is recognised. The fact that the cumulative amount of exchange differences will be fixed under EMU does not justify immediate recognition as income or expenses since the wording and the rationale of AASB 121.48 clearly preclude such a treatment.

Date of SIC's Consensus: [Deleted by the UIG]

Effective Date of SIC-7: [Deleted by the UIG]

REFERENCES

Australia

The Urgent Issues Group discussed Issues Paper UIG/SIC 03/1 "Adoption of Interpretation SIC-7 in Australia" at its meetings on 4 December 2003 and 12 February 2004.

Accounting Standard AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*

Accounting Standard AASB 110 *Events after the Balance Sheet Date*

Accounting Standard AASB 121 *The Effects of Changes in Foreign Exchange Rates*

Accounting Standard AASB 139 *Financial Instruments: Recognition and Measurement*

International Accounting Standards Board

International Accounting Standard IAS 21 *The Effects of Changes in Foreign Exchange Rates*

Standing Interpretations Committee Interpretation SIC-7 *Introduction of the Euro*