IAS 21 The Effects of Changes in Foreign Exchange Rates

(This fact sheet is based on the standard as at 1 January 2010.)

Important note:
This fact sheet is based on the requirements of the International Financial Reporting Standards (IFRSs). In some jurisdictions, the IFRSs are adopted in their entirety, in other jurisdictions the individual IFRSs are amended. In some jurisdictions the requirements of a particular IFRS may not have been adopted. Consequently, users of the fact sheet in various jurisdictions should ascertain for themselves the relevance of the fact sheet to their particular jurisdiction. The application date included below is the effective date of the most recent changes made to the standard.

IASB application date (non-jurisdiction specific)
IAS 21 is applicable for annual reporting periods commencing on or after 1 July 2009.

OBJECTIVE
The objective of IAS 21 is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.

SCOPE
IAS 21 applies in:
• accounting for transactions and balances in foreign currencies except for derivatives within the scope of IAS 39 Financial instruments: recognition and measurement
• translating the results and financial position of foreign operations
• translating entity's results and financial position into a presentation currency.

PRESCRIBED ACCOUNTING TREATMENT
Functional currency
All transactions are recognised in the functional currency of the entity. All currencies other than the functional currency are foreign currencies. A legal or economic entity may have more than one functional currency if it has a foreign operation (subsidiary, associate, joint venture or branch with activities based or conducted in a different country or currency). The basis for determining each entity's functional currency is discussed below.

The functional currency of an entity depends on the primary economic environment, which is normally the environment in which the entity ‘primarily generates and expends cash’. Primary factors considered in identifying the functional currency are the currency:
• with the main influences on selling prices of goods and services
• of the main country whose competitive forces and regulations determine the selling prices of goods and services
• with the main currency influencing labour, material and other costs of providing goods or services.

The following may also provide evidence of the functional currency; however the results of these tests do not over-ride the results of the primary factors test:
• the currency in which funds are generated from debt and equity instruments
• the currency in which receipts from operating activities are usually retained
International Financial Reporting Standards (IFRS)

- in determining the functional currency of a foreign operation and whether its functional currency is the same as 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):
  - whether its activities are an extension of the reporting entity’s activities rather than involving significant autonomy
  - the proportion of its transactions that are with the reporting entity
  - whether its cash flows directly affect those of the reporting entity and are readily distributable to it
  - whether its cash flows are sufficient to service its existing and normally expected debt obligations without assistance from the reporting entity.

Recognition and measurement

Initial recognition
A foreign currency transaction is 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.

Subsequent reporting periods
At subsequent reporting dates:
  - any foreign currency denominated monetary items are remeasured using the closing rate;
  - non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of transaction;
  - non-monetary items that are measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Exchange differences
Any exchange difference arising on the settlement of a monetary item or on translating monetary items at rates different from those in which they were initially translated are included in net profit unless it relates to a remeasurement recognised directly in other comprehensive income or a monetary item forming part of the net investment in a foreign operation in the consolidated statements.

When a gain or loss on a non-monetary item is recognised in other comprehensive income, any exchange component of that gain or loss is recognised in other comprehensive income. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.

Translation into presentation currency
An entity may elect to present its financial report in any currency (referred to as the presentation currency). For operations where the functional currency is not the presentation currency:
  - assets and liabilities are translated to the presentation currency using the closing rate at reporting date;
  - income and expenses are translated using the exchange rate at the transaction date; and
  - any resulting exchange difference is recognised in other comprehensive income.

For groups, translation of each entity within the group to the group’s presentation currency is performed before preparing the consolidated financial report. A similar process is also adopted in an individual entity’s financial statements where, for example, there is a branch operation with a different functional currency.

DISCLOSURES
Refer Appendix 1 for a checklist to assist with IAS 21 disclosure requirements.
IMPORTANT DEFINITIONS

<table>
<thead>
<tr>
<th>Term</th>
<th>Description</th>
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<tr>
<td>Closing rate</td>
<td>spot exchange rate at the reporting date.</td>
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<td>Exchange differences</td>
<td>the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.</td>
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<td>Exchange rate</td>
<td>the ratio of exchange for two currencies.</td>
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<td>Foreign currency</td>
<td>a currency other than the functional currency of the entity.</td>
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<td>Foreign operation</td>
<td>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.</td>
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<td>Functional currency</td>
<td>the currency of the primary economic environment in which the entity operates.</td>
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<td>Net investment in a foreign operation</td>
<td>the amount of the reporting entity’s interest in the net assets of that operation.</td>
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<td>Presentation currency</td>
<td>the currency in which the financial report is presented.</td>
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AUSTRALIAN SPECIFIC REQUIREMENTS

The Australian equivalent standard is AASB 121 which is applicable for annual reporting periods beginning on or after 1 July 2009.

APPENDIX 1 – DISCLOSURE CHECKLIST

This checklist can be used to review your financial statements – you should complete the Yes / No / N/A column about whether the requirement is included and provide an explanation for No answers to ensure the completeness of disclosures.

<table>
<thead>
<tr>
<th>IAS 21: The Effects of Changes in Foreign Exchange Rates – Applicable for financial statement periods beginning on or after 1 July 2009.</th>
<th>Yes / No / N/A</th>
<th>Explanation (if required)</th>
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<tr>
<td>IAS 21.52 Has the entity disclosed:</td>
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<td>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 IAS 39; and</td>
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<td>b) net exchange differences recognised in other comprehensive income and accumulated in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.</td>
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<td>IAS 21.53 If the presentation currency is different from the functional currency, has the entity disclosed this fact?</td>
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<td>IAS 21.54 Have there been changes in the functional currency of either the reporting entity or a significant foreign operation? Is yes, has that fact and the reason for the change in functional currency been disclosed.</td>
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<td>IAS 21.55 Does the entity present its financial statements in a currency that is different from its functional currency? If yes, has the entity described the financial statements as complying with 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.</td>
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<td>IAS 21.57</td>
<td>Yes / No / N/A</td>
<td>Explanation (if required)</td>
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<td>Does the entity display its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and it does not meet the above requirements at IAS 21.55 has the entity: a) clearly identified the information as supplementary information to distinguish it from the information that complies with IFRSs; b) disclosed the currency in which the supplementary information is displayed; and c) disclosed the entity's functional currency and the method of translation used to determine the supplementary information.</td>
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