IAS 21
Effects of changes in foreign exchange rates

1. Objective

IAS 21 specifies the exchange rate to use for transactions expressed in foreign currency and foreign operations, and how to report the effects of changes in the exchange rate in the financial statements of both individual companies and groups.

2. Scope

IAS 21 is applied in:

- accounting for all transactions and all balances in foreign currency, except for derivative transactions and hedge accounting (see IFRS 9);
- translating the results and financial situation of foreign operations that are included in the financial statements of the entity regardless of the consolidation method used;
- translating the results and financial position of a company from a functional currency into a presentation currency.

The Standard sets out the distinction between monetary and non-monetary items as follows:

- 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;
- non-monetary items do not result in the right to receive or the obligation to deliver a set or determinable number of units of currency.

The functional currency is the currency of the primary economic environment in which the company operates. It may be different from the presentation currency which is the currency in which the financial statements are presented.

3. Accounting impact

Transactions in a company's individual accounts denominated in a foreign currency may include:

- purchases or sales of goods or services,
- borrowing or lending of funds,
- purchases or sales of assets, or settlement of liabilities.

On initial recognition, a foreign currency transaction should be recorded in the functional currency. This amount is determined by converting the amount in foreign currency using the spot exchange rate at the date of the transaction.
The Standard requires the use of the spot exchange rate in force at the date of each transaction. However, for practical reasons, an average rate for the period (week or month) may be used if the exchange rate does not fluctuate significantly.

At the end of each reporting period:

- foreign currency monetary items must be translated using the closing rate;
- non-monetary items (inventories, tangible assets) that are measured in terms of historical cost continue to be translated using the spot exchange rate at the date of the transaction;
- non-monetary items that are measured at fair value, should be translated using the exchange rate at the date when the fair value was measured.

3.1 Recognition of exchange rate differences in the accounts of individual companies

Exchange differences arising on the settlement of monetary items should be recognized as **income or expenses in the period** in which they arise.
Unrealized exchange differences arising from the re-translation of monetary items at the end of the reporting period should be recognized as income or expenses.

The exchange rate differences related to an **intra-group monetary item**, that forms part of a company's net investment in a foreign entity, must be recognized in equity until the **disposal of the investment.**

Example 1: European company X purchased goods from American company Y in December N. The total amount of the invoice amounts to USD 10,000.00. The exchange rate at the time the goods were received is USD 1.3063 = EUR 1. The invoice would be recognized in X's accounts as follows:

Purchases of merchandise (P&L)	EUR	7,654.92	
Supplier Y (B/S) (10,000/1.30)	EUR		7,654.92

On 31 December N, the goods were still in inventory and supplier Y still had not settled payment. The exchange rate was 1.32.

The debt, corresponding to a monetary item, must be measured at the closing rate. The foreign exchange gain of EUR 79.17 must be recognized as follows:

Supplier Y (B/S) (10,000/1.32) – (10,000/1.3063)	EUR	79.17	
Foreign exchange gain (P&L)	EUR		79.17

The inventory is a non-monetary item. The change in inventory would therefore be recognized at the historical rate:

Inventory (B/S)	EUR	7,654.92	
Change in inventory (P&L)	EUR		7,654.92

On January 28 N+1, the invoice was settled by bank transfer. The bank makes a charge to X's account amounting to EUR 7,808.00 (excluding banking fees). Due to the impact of the unrealized exchange difference at 1st January N+1, the following items would be recognized:

Supplier Y (B/S)	EUR	7,654.92	
Foreign exchange loss (P&L)	EUR	153.08	
Bank account (B/S)	EUR		7,808.00

3.2 Translation into a presentation currency of different functional currencies used in other entities' accounts

The Standard refers to foreign operations, via a subsidiary, associated company, joint venture or branch, whose financial statements are consolidated with those of the parent company.
The translation of the financial statements of such a foreign entity, assuming it is not located in a hyperinflationary country, is carried out as follows:

- all the **assets and liabilities** are translated at the **closing rate**
- **income and expenses** are translated at the **exchange rates at the date of the various transactions** (in practice, average rates are normally used)
- all resulting **exchange differences** shall be recognized directly **in equity** in a

separate component of equity (often referred to as a foreign currency translation reserve).

Example 2: The financial statements for the first reporting period of a Swiss company, a German company's subsidiary, would be translated as follows (closing rate: EUR 1 = CHF 1.21; average rate for the year: EUR 1 = CHF 1.15; historical rate at the time the equity is paid: EUR 1 = CHF 1.50):

Balance sheet					
Assets (total)	CHF	20,300.00	1.21	EUR	24,563.00
Liabilities	CHF	9,400.00	1.21	EUR	7,768.60
Capital	CHF	10,000.00	1.50	EUR	6,666.67
Profit for the reporting period	CHF	900.00	1.15	EUR	782.61
Currency translation reserve				EUR	9,345.12

The financial statements of a foreign entity whose functional currency is the currency of a hyperinflationary economy should restate its financial statements in accordance with IAS 29, "Financial reporting in hyperinflationary economies". The translation method applicable to this situation is set out in IAS 21.

3.3 Disposal of a foreign subsidiary

On the disposal of a foreign subsidiary, the aggregate amount of the **exchange differences** that were **deferred** in a separate component of equity, and that are related to this foreign entity, must be recognized as income or expenses during the reporting period when the disposal occurs.

4. Disclosure

The financial statements must disclose the following:

- The exchange rates applied;
- The amount of realized and unrealized exchange differences included in profit or loss for the reporting period;
- Net exchange differences recognized in a separate component of equity and a reconciliation of the amount of such exchange differences at the beginning and at the end of the reporting period;
- The reasons leading the entity to use a presentation currency that is different from the functional currency;
- Any changes in the functional currency of either the reporting entity or a significant foreign operation.