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## IAS 21 — The Effects of Changes in Foreign Exchange Rates

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### Overview

IAS 21 *The Effects of Changes in Foreign Exchange Rates* outlines how to account for foreign currency transactions and operations in financial statements, and also how to translate financial statements into a presentation currency. An entity is required to determine a functional currency (for each of its operations if necessary) based on the primary economic environment in which it operates and generally records foreign currency transactions using the spot conversion rate to that functional currency on the date of the transaction.

IAS 21 was reissued in December 2003 and applies to annual periods beginning on or after 1 January 2005.

### History of IAS 21

December 1977	Exposure Draft E11 <i>Accounting for Foreign Transactions and Translation of Foreign Financial Statements</i>
March 1982	E11 was modified and re-exposed as Exposure Draft E23 <i>Accounting for the Effects of Changes in Foreign Exchange Rates</i>
July 1983	IAS 21 <i>Accounting for the Effects of Changes in Foreign Exchange Rates</i>
1 January 1985	Effective date of IAS 21 (1983)
1993	IAS 21 (1983) was revised as part of the comparability of financial statements project
May 1992	Exposure Draft E44 <i>The Effects of Changes in Foreign</i>

	<i>Exchange Rates</i>
December 1993	IAS 21 (1993) <i>The Effects of Changes in Foreign Exchange Rates</i> (revised as part of the 'Comparability of Financial Statements' project)
1 January 1995	Effective date of IAS 21 (1993)
18 December 2003	Revised version of IAS 21 issued by the IASB
1 January 2005	Effective date of IAS 21 (Revised 2003)
December 2005	Minor Amendment to IAS 21 relating to net investment in a foreign operation
1 January 2006	Effective date of the December 2005 amendments
10 January 2008	Some revisions of IAS 21 as a result of the Business Combinations Phase II Project relating to disposals of foreign operations
1 July 2009	Effective date of the January 2008 amendments

## Related Interpretations

- [IFRIC 16](#) *Hedge of a Net Investment in a Foreign Operation*
- [SIC-30](#) *Reporting Currency – Translation from Measurement Currency to Presentation Currency*. **SIC-30 was superseded and incorporated into the 2003 revision of IAS 21.**
- [SIC-19](#) *Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*. **SIC-19 was superseded and incorporated into the 2003 revision of IAS 21.**
- [SIC-11](#) *Foreign Exchange – Capitalisation of Losses Resulting from Severe Currency Devaluations*. **SIC-11 was superseded and incorporated into the 2003 revision of IAS 21.**
- [SIC-7](#) *Introduction of the Euro*

## Amendments under consideration by the IASB

- [Research project — Foreign currency translation](#)

## Summary of IAS 21

### Objective of IAS 21

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. [IAS 21.1] The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements. [IAS 21.2]

## Key definitions [IAS 21.8]

**Functional currency:** the currency of the primary economic environment in which the entity operates. (The term 'functional currency' was used in the 2003 revision of IAS 21 in place of 'measurement currency' but with essentially the same meaning.)

**Presentation currency:** the currency in which financial statements are presented.

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

**Foreign operation:** a subsidiary, associate, joint venture, or branch whose activities are based in a country or currency other than that of the reporting entity.

## Basic steps for translating foreign currency amounts into the functional currency

Steps apply to a stand-alone entity, an entity with foreign operations (such as a parent with foreign subsidiaries), or a foreign operation (such as a foreign subsidiary or branch).

1. the reporting entity determines its functional currency
2. the entity translates all foreign currency items into its functional currency
3. the entity reports the effects of such translation in accordance with paragraphs 20-37 [reporting foreign currency transactions in the functional currency] and 50 [reporting the tax effects of exchange differences].

## Foreign currency transactions

A foreign currency transaction should be recorded initially at the rate of exchange at the date of the transaction (use of averages is permitted if they are a reasonable approximation of actual). [IAS 21.21-22]

At each subsequent balance sheet date: [IAS 21.23]

- foreign currency monetary amounts should be reported using the closing rate
- non-monetary items carried at historical cost should be reported using the exchange rate at the date of the transaction
- non-monetary items carried at fair value should be reported at the rate that existed when the fair values were determined

Exchange differences arising when monetary items are settled or when monetary items are translated at rates different from those at which they were translated when initially recognised or in previous financial statements are reported in profit or loss in the period, with one exception. [IAS 21.28] The exception is that exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognised, in the consolidated financial statements that include the foreign operation, in other comprehensive income; they will be recognised in profit or loss on disposal of the net investment. [IAS 21.32]

As regards a monetary item that forms part of an entity's investment in a foreign operation, the accounting treatment in consolidated financial statements should not be dependent on the currency of the monetary item. [IAS 21.33] Also, the accounting should not depend on which entity within the group conducts a transaction with the foreign operation. [IAS 21.15A] If a gain or loss on a non-monetary item is recognised in other comprehensive income (for example, a property revaluation under IAS 16), any foreign exchange component of that gain or loss is also recognised in other comprehensive income. [IAS 21.30]

### **Translation from the functional currency to the presentation currency**

The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy are translated into a different presentation currency using the following procedures: [IAS 21.39]

- assets and liabilities for each balance sheet presented (including comparatives) are translated at the closing rate at the date of that balance sheet. This would include 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 are treated as part of the assets and liabilities of the foreign operation [IAS 21.47];
- income and expenses for each income statement (including comparatives) are translated at exchange rates at the dates of the transactions; and
- all resulting exchange differences are recognised in other comprehensive income.

Special rules apply for translating the results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy into a different presentation currency. [IAS 21.42-43]

Where the foreign entity reports in the currency of a hyperinflationary economy, the financial statements of the foreign entity should be restated as required by [IAS 29 \*Financial Reporting in Hyperinflationary Economies\*](#), before translation into the reporting currency. [IAS 21.36]

The requirements of IAS 21 regarding transactions and translation of financial statements should be strictly applied in the changeover of the national currencies of participating Member States of the European Union to the Euro – monetary assets and liabilities should continue to be translated the closing rate, cumulative exchange differences should remain in equity and exchange differences resulting from the translation of liabilities denominated in participating currencies should not be included in the carrying amount of related assets. [[SIC-7](#)]

### **Disposal of a foreign operation**

When a foreign operation is disposed of, the cumulative amount of the exchange differences recognised in other comprehensive income and accumulated 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. [IAS

21.48]

## Tax effects of exchange differences

These must be accounted for using [IAS 12 Income Taxes](#).

## Disclosure

- The amount of exchange differences recognised in profit or loss (excluding differences arising on financial instruments measured at fair value through profit or loss in accordance with IAS 39) [IAS 21.52(a)]
- 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 [IAS 21.52(b)]
- When the presentation currency is different from the functional currency, disclose that fact together with the functional currency and the reason for using a different presentation currency [IAS 21.53]
- A change in the functional currency of either the reporting entity or a significant foreign operation and the reason therefor [IAS 21.54]

When an entity presents its financial statements in a currency that is different from its functional currency, it may describe those financial statements as complying with IFRS only if they comply with all the requirements of each applicable Standard (including IAS 21) and each applicable Interpretation. [IAS 21.55]

## Convenience translations

Sometimes, 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 simply by translating all amounts at end-of-period exchange rates. This is sometimes called a convenience translation. A result of making a convenience translation is that the resulting financial information does not comply with all IFRS, particularly IAS 21. In this case, the following disclosures are required: [IAS 21.57]

- Clearly identify the information as supplementary information to distinguish it from the information that complies with IFRS
- Disclose the currency in which the supplementary information is displayed
- Disclose the entity's functional currency and the method of translation used to determine the supplementary information



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