FRS-21
Issued 12/97
Amended 04/98

Institute of Chartered Accountants of New Zealand

FINANCIAL REPORTING STANDARD NO. 21
1997

ACCOUNTING FOR THE EFFECTS OF CHANGES IN FOREIGN CURRENCY EXCHANGE RATES

Issued by the Financial Reporting Standards Board
Institute of Chartered Accountants of New Zealand

Approved December 1997 by the Accounting Standards Review Board under the Financial Reporting Act 1993

CONTENTS

Paragraph

Introduction 1.1
Application 2.1
Statement of Purpose 3.1
Definitions 4.1
Foreign Currency Transactions
Initial Recognition of Transactions 5.1
Reporting the Effects of Changes in Exchange Rates Subsequent to Initial Recognition 5.3
Recognition of Exchange Differences 5.4
Financial Statement Translation
Classification of Foreign Operations 6.1
Translation of Financial Statements of Independent Foreign Operations 6.5
Translation of Financial Statements of Integrated Foreign Operations 6.14
Change in the Classification of Foreign Operations 6.16
Disposal of Independent Foreign Operations 6.18
Disclosures 7.1
Transitional Provision 8.1
Appendices
Comparison of FRS-21 with International and Australian Accounting Standards .... Appendix 1
Illustration of Application of Paragraphs 5.3(c), 5.4(b) and 6.14 .... Appendix 2

This Standard partially replaces SSAP-21: Accounting for the Effects of Changes in Foreign Currency Exchange Rates (1988), although that Standard will continue to apply in full until the completion of accounting periods beginning prior to 1 January 1998.

When FRS-21 applies, paragraphs 5.3, 5.5, 5.6, 5.8 and 5.13(d) of SSAP-21 will remain in effect together with the relevant discussion and definition paragraphs.

This Standard should be read in the context of the Explanatory Foreword to General Purpose Financial Reporting published by the Council, Institute of Chartered Accountants of New Zealand.

The Accounting Standards Review Board (the Board) has approved FRS-21: Accounting for the Effects of Changes in Foreign Currency Exchange Rates, for the purposes of the Financial Reporting Act 1993, to apply to all reporting entities, the Crown and all departments, Offices of Parliament and Crown entities (each of which is defined in the Act) other than as expressly exempted by the terms of the Standard.

The Board has also approved this Standard to apply to local authorities (as defined in the Act) from 1 July 1998.

1 INTRODUCTION

COMMENTARY

1.1 This Standard deals with:

(a) the translation of transactions and balances measured in foreign currencies; and

(b) the translation of the financial statements of foreign operations into a single reporting currency for the purpose of including them in the financial report of the entity reporting.

1.2 This Standard does not deal with accounting for hedging transactions other than the classification of certain exchange differences arising in connection with the hedging of a net investment in an independent foreign operation. Reference should be made to Statement of Standard Accounting Practice SSAP-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates* for guidance on accounting for certain hedging transactions. In this respect, compliance with SSAP-21 is still required.

1.3 An entity may engage in two forms of foreign currency transactions:

(a) It may have transactions in foreign currencies. For example, an entity may purchase or sell goods for which payment is made and balances measured in a foreign currency, or it may lend or borrow foreign currency. In order to prepare the financial report of the entity, transactions and balances measured in foreign currencies need to be translated into the reporting currency of the entity.

(b) It may have foreign operations. In order to prepare the financial report incorporating the activities of foreign operations, the financial statements of those operations need to be translated into the reporting currency of the entity reporting.

1.4 The principal issues in accounting for foreign currency transactions and foreign operations are:

(a) the exchange rate to be used; and

(b) the recognition and disclosure in the financial statements of the financial effects of changes in exchange rates.

1.5 This Standard does not specify the currency in which an entity reporting presents its financial report. However, an entity reporting normally uses the currency of the country in which it is domiciled. If it uses a different currency, this Standard requires disclosure of the reason for using that currency. This Standard also requires disclosure of the reason for any change in the reporting currency.

1.6 Financial reporting standards are paragraphs in bold type-face in this Standard. Where appropriate, interpretive commentary paragraphs in plain type-face follow the financial reporting standards.

2 APPLICATION

STANDARD

2.1 This Standard applies to the general purpose financial reports of all entities except where exempted by paragraph 2.2 or paragraph 2.3.

2.2 Entities that qualify in accordance with the *Framework for Differential Reporting* are not required to:

(a) translate transactions measured in a foreign currency using the exchange rate in effect at the transaction date, or at a rate approximating this rate, as required by paragraph 5.1 of this Standard. If transactions are not translated at the rate in effect at the transaction date, or a rate approximating this rate, then transactions settled in the accounting period shall be translated at the settlement rate, and transactions unsettled at balance date shall be translated at the closing rate in accordance with paragraph 5.3 of this Standard; or

(b) separately disclose the net exchange difference included in the statement of financial performance for the period as required by paragraph 7.1(b) of this Standard.

2.3 Life Insurers that comprehensively adopt market value accounting are not required to comply with paragraph 6.5(c) of this Standard.

2.4 The financial reporting standards set out in this Standard shall apply to all financial reports where such application is of material consequence. A

statement, fact, or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the financial report is completed, is likely to influence the users of the financial report in making decisions or assessments.

2.5 This Standard applies to general purpose financial reports covering periods beginning on or after 1 January 1998.

3 STATEMENT OF PURPOSE

COMMENTARY

3.1 The purpose of this Standard is to:

(a) specify the accounting treatment for transactions and balances measured in a foreign currency;

(b) specify methods of translating the financial statements of a foreign operation so as to reflect the underlying relationship between the entity reporting and the foreign operation; and

(c) require disclosure of information that will assist users of the financial report of an entity reporting to assess the significance of movements in the exchange rates of foreign currencies to which the entity is exposed.

3.2 This Standard does not deal with the hedging of foreign currency assets, liabilities and unrecognised commitments other than the classification of exchange differences arising on a foreign currency liability accounted for as a hedge of a net investment in an independent foreign operation.

4 DEFINITIONS

STANDARD

The following terms are used in this Standard with these meanings:

4.1 "Closing rate" is the spot rate at the balance date of the entity reporting.

4.2 "Entity reporting" for the purposes of this Standard only, and when used in context that addresses the relationship between a foreign operation and the rest of the entity or group entity, shall be taken to mean the entity excluding the foreign operation.

COMMENTARY

4.3 When a relationship between a foreign operation and the entity reporting is described, it is important to view the foreign operation as if it were a separate entity from the entity reporting. A foreign branch operation, referred to in paragraph 4.8, should also be viewed as though it were a separate entity from the entity reporting.

STANDARD

4.4 "Exchange difference" is the difference resulting from translating the same number of units of foreign currency at differing exchange rates.

4.5 "Exchange rate" is the ratio for exchange of two currencies.

4.6 "Foreign currency" is a currency other than the reporting currency of the entity reporting.

4.7 "Foreign currency monetary liability" is a monetary liability denominated in a foreign currency, regardless of the form in which the liability originated.

4.8 "Foreign operation" is a subsidiary, in-substance subsidiary, associate, joint venture, branch or other form of operation, whose activities are based or conducted in, and whose financial report is prepared in, a foreign currency.

4.9 "Monetary items" is money held and items to be received or paid in fixed or determinable amounts of money. All other assets and liabilities are non-monetary items.

4.10 "Net investment in a foreign operation" is the entity reporting's share in the reported net assets of the foreign operation together with any long-term, intra-group balances that are in effect equity related to the acquisition or financing of that operation.

COMMENTARY

4.11 It is common for the financing arrangements between the parent entity and the foreign operation to involve long-term indebtedness rather than funding solely by way of equity. The indebtedness may be denominated either in New Zealand dollars or in the currency of the foreign operation. The indebtedness is frequently permanent in nature, and there may or may not be interest flows attached to that indebtedness. The acquisition or financing of the operations referred to in paragraph 4.10 does not mean the use of trading accounts in the normal course of business.

STANDARD

4.12 "Reporting currency" is the currency used in presenting the financial report.

4.13 "Settlement date" is the date at which a receivable is collected or a payable is paid.

4.14 "Spot rate" is the exchange rate for immediate delivery of currencies to be exchanged.

4.15 "Transaction date" is the date at which a transaction is recognised in the accounting records of the entity reporting, in conformity with generally accepted accounting practice.

COMMENTARY

4.16 Recognition of a transaction will occur either when a transaction gives rise to an element at the time the transaction occurs or at a subsequent time because the element could not be recognised at the time the transaction occurred.

STANDARD

4.17 "Translation" is the process by which financial data measured in one currency are expressed in terms of another currency. It includes both the expression of individual transactions in terms of another currency and the expression of a complete set of financial statements prepared in one currency in terms of another currency.

5 FOREIGN CURRENCY TRANSACTIONS

Initial Recognition of Transactions

STANDARD

5.1 Except as permitted by paragraph 5.3 of SSAP-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates,* transactions measured in a foreign currency shall be reported, on initial recognition in the reporting currency, by applying to the foreign currency amount the spot rate at the transaction date or a rate approximating that rate.

COMMENTARY

5.2 A transaction in a foreign currency is recognised in the financial statements of an entity as at the transaction date, normally using the exchange rate at that date (spot rate). For practical reasons, a rate that approximates the actual rate is often used; for example, an average rate for all transactions during the week or month in which the transactions occur. However, if the exchange rate fluctuates significantly, the use of a simple average rate for a period may be unreliable.

Reporting the Effects of Changes in Exchange Rates Subsequent to Initial Recognition

STANDARD

5.3 Except as permitted by paragraph 5.3 of SSAP-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates*, at each reporting date:

(a) foreign currency monetary items shall be translated using the closing rate;

(b) non-monetary items that are carried at historical cost and measured in a foreign currency shall be translated using the spot rate at the transaction date or a rate approximating that rate; and

(c) **non-monetary items that are carried at other than historical cost and measured in a foreign currency shall be translated using the spot rate that existed when the values of those non-monetary items were determined.**

Recognition of Exchange Differences

STANDARD

5.4 Except for exchange differences accounted for in accordance with paragraphs 6.5, 6.9and 6.10, or where a hedging transaction accounted for in accordance with paragraphs 5.3, 5.5, 5.6 and 5.8 of SSAP-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates* exists:

(a) exchange differences arising on settlement of monetary items or from reporting an entity's foreign currency monetary items at rates different from those at which they were recognised during the period, or reported in previous financial statements, shall be recognised as revenue or expense in the statement of financial performance for the period in which they arise; and

(b) exchange differences arising on non-monetary items at the date of revaluation shall be accounted for in the same manner as the change in the value of the non-monetary item.

COMMENTARY

5.5 An exchange difference results when there is a change in the exchange rate between the transaction date and the settlement date of any monetary items arising from a foreign currency transaction.

5.6 When a transaction is settled within the same accounting period as it occurred, the exchange difference between the amount originally recorded and the settlement amount is reflected in the cash flows of the period and is to be included as revenue or expense in the statement of financial performance for the period.

5.7 Except as permitted by paragraph 5.3 of SSAP-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates*, when a transaction is not settled in the same accounting period in which it occurred, the foreign currency monetary item is to be translated at the closing rate. The difference between the amount presented in the current financial report and any amount at which the transaction was presented in the previous financial report, or initially recognised in the current period, is regarded as an unrealised foreign exchange gain or loss. In order to reflect the impact of a foreign currency exchange movement on the performance of the entity reporting, and to assist with the prediction of future cash flows, unrealised exchange gains and losses on monetary items are to be included in the statement of financial performance for the period. The closing rate is considered the best indication of how the payable or receivable would be settled.

5.8 A revalued non-monetary item that is measured in a foreign currency is translated at the spot rate in existence when its value is determined. This Standard adopts the view that the translation element of any such valuation adjustment should be accounted for in the same way the underlying change in value of the non-monetary item is accounted for. For example, the translation of a revaluation of a building measured in a foreign currency will result in a revaluation component which will be recognised through an asset revaluation reserve. Any translation element should therefore be recognised in the asset revaluation reserve along with the revaluation component.

6 FINANCIAL STATEMENT TRANSLATION

Classification of Foreign Operations

STANDARD

6.1 The method used to translate the financial statements of a foreign operation for the purpose of the entity reporting depends on the way in which the operation is financed and operates in relation to the entity reporting. In this Standard, foreign operations are classified as either:

(a) independent foreign operations, or

(b) integrated foreign operations.

If the activities of a foreign operation are an integral part of those of the entity reporting, the operation is described as an integrated foreign operation; otherwise it is described as an independent foreign operation.

COMMENTARY

6.2 Independent foreign operations accumulate cash and other monetary items, incur expenses and costs, earn revenues and perhaps arrange financing, substantially in the foreign currency. When there is a change in the exchange rate, there is little or no direct effect on the activities, or present and future cash flows, of either the entity reporting or the foreign operation because the foreign operation is not an integral part of the operations of the entity reporting. The significance of the exchange rate change to the entity reporting would be its effect on the net investment in the foreign operation rather than on the individual monetary and non-monetary items held by the foreign operation.

6.3 An integrated foreign operation is an integral part of the operations of the entity reporting as if it were an extension of the operation of the entity reporting. The effect on the cash flows of the entity reporting of a change in the exchange rate would be almost immediate and would be of a similar effect if the entity reporting had conducted the activities itself. Thus, the effect of an exchange rate change in the case of an integrated foreign operation is related to the monetary

items held by the foreign operation, rather than to the net investment of the entity reporting in that operation.

6.4 Whether a foreign operation should be regarded as independent or integrated depends on particular circumstances. Matters to be considered in making this decision include the following:

(a) Whether costs of materials, labour and other components of the foreign operation's product are primarily local costs, or whether the foreign operation depends on goods and services obtained primarily from the country in which the entity reporting is located, or transacted in the currency of the entity reporting: Costs that are primarily local costs suggest the operations are independent.

(b) Whether there is little relationship between the day-to-day activities of the foreign operation and the entity reporting, or whether transactions with the entity reporting represent a high proportion of the foreign operation's day-to-day activities: Activities carried out with a significant degree of autonomy from the entity reporting, or transactions with the entity reporting that are a low proportion of the foreign operation's activities, suggest the operations are independent.

(c) Whether the day-to-day activities of the foreign operations are financed mainly from its own operations and local borrowings or whether there is dependence on finance provided by the entity reporting: Local borrowings and self-financing suggest the operations are independent.

(d) Whether the foreign operation's market is mainly outside the country of the entity reporting or in a currency other than that of the entity reporting: A market predominantly outside the country of the entity reporting or in a foreign currency suggests the operations are independent.

(e) Whether there are other factors that would indicate that the cash flows of the entity reporting are insulated from, or affected by, the day-to-day activities of the foreign operation: Insulated cash flows suggest the operations are independent.

(f) Whether a foreign operation acts as a selling agency which receives stocks of goods from the entity reporting and remits the proceeds to the entity reporting: Where this is the case it suggests the operations are integrated.

(g) Whether the foreign operation produces a raw material, or manufactures or sub-assembles parts which are used by the entity reporting for inclusion in its own products: Such production suggests the operations are integrated.

(h) Whether the foreign operation is located overseas primarily for tax or other regulatory purposes, or to act as a means of raising finance for the entity reporting: These reasons for location suggest the operations are integrated.

Translation of the Financial Statements of Independent Foreign Operations

STANDARD

6.5 The financial statements of an independent foreign operation shall be translated as follows:

(a) Assets and liabilities shall be translated at the closing rate.

(b) Revenue and expense items shall be translated using the spot rate at the transaction date or at a rate approximating that rate.

(c) All resulting exchange differences arising from (a) and (b) above shall be taken to the foreign currency translation reserve and recognised in the statement of movements in equity.

(d) For the purposes of presentation in the statement of cash flows, cash inflows and outflows shall be translated at the spot rate at the date of the cash flow or at a rate approximating that rate.

COMMENTARY

6.6 For practical reasons, a rate that approximates the actual rate is often used to translate revenue and expense items of foreign operations; for example, an average rate for all transactions during the week or month in which the transactions occur.

6.7 The translation of the financial statements of independent foreign operations results in the recognition of exchange differences arising from:

(a) translating revenue and expense items at the exchange rates at the dates of transactions, or rates approximating those rates, and assets and liabilities at the closing rate;

(b) translating the opening net investment in the independent foreign operation at an exchange rate different from that at which it was previously reported; and

(c) other changes to equity in the independent foreign operation.

These exchange differences are not recognised as revenue or expenses in the statement of financial performance because the changes in the exchange rates have little or no direct effect on the present and future cash flows from operations of either the independent foreign operation or the entity reporting.

6.8 When an independent foreign operation is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and reported as part of, the minority interest in the consolidated statement of financial position.

STANDARD

6.9 In the consolidated group financial statements, if a foreign currency monetary liability is designated a hedge of a net investment in an independent foreign operation, any exchange difference on that liability shall be taken to

the foreign currency translation reserve and recognised in the statement of movements in equity to the extent that it is offset by the exchange difference on the net investment. When any exchange difference on such a liability exceeds the exchange differences arising on the net investment that the liability hedges, these excess exchange differences shall be recognised in the statement of financial performance in the period.

6.10 When long-term indebtedness exists between the entity reporting and the independent foreign operation that, in substance, forms part of the entity reporting's net investment in the independent foreign operation, such indebtedness shall be treated, for the purpose of translation, as equity and not as a monetary item. In the consolidated group financial statements, exchange differences on the indebtedness shall be taken to the foreign currency translation reserve and recognised in the statement of movements in equity.

COMMENTARY

6.11 An entity reporting may have a monetary item that is a receivable from, or payable to, an independent foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension to or deduction from the entity reporting's net investment in that independent foreign operation. Such monetary items are long term in nature and therefore exclude normal trade receivables and payables. In the consolidated group financial statements, exchange differences on such long-term indebtedness are to be taken to the foreign currency translation reserve and recognised in the statement of movements in equity.

6.12 Any goodwill arising from the acquisition of an independent 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 either:

(a) assets and liabilities of the independent foreign operation and translated at the closing rate; or

(b) assets and liabilities of the entity reporting which either are already expressed in the reporting currency, or are non-monetary foreign currency items which are reported using the exchange rate at the date of the transaction.

6.13 Goodwill that is reported in the independent foreign operation's statement of financial position will be translated as a non-monetary asset at closing rate.

Translation of the Financial Statements of Integrated Foreign Operations

STANDARD

6.14 The financial statements of an integrated foreign operation shall be translated in the same way as if the underlying transactions had been entered into by the entity reporting.

COMMENTARY

6.15 When translating the financial statements of an integrated foreign operation, it is appropriate to incorporate the individual items of the foreign operation's financial statements into those of the entity reporting in a manner that will achieve the same result as if all transactions of the foreign operation had been entered into by the entity reporting itself (refer to paragraph 5.3).

Change in the Classification of Foreign Operations

STANDARD

6.16 A change in the way in which a foreign operation is financed and operates in relation to the entity reporting may lead to a change in the classification of that foreign operation:

(a) when an integrated foreign operation is reclassified as independent, exchange differences arising on the translation of non-monetary items at the date of the reclassification shall be taken to the foreign currency translation reserve and recognised in the statement of movements in equity; and

(b) when an independent foreign operation is reclassified as integrated,

  (i) the translated amounts for non-monetary items at the date of the change shall be treated as the historical cost for those items in the period of the change and subsequent periods, and

  (ii) the accumulated amount of the exchange differences taken to the foreign currency translation reserve that relate to the foreign operation and to any monetary liability designated as a hedge of that operation shall be transferred out of the foreign currency translation reserve but shall remain within equity. The amount of the exchange differences shall not be taken to the statement of financial performance nor recognised in the statement of movements in equity.

6.17 Where there is a change in the classification of a foreign operation, the translation procedures applicable to the revised classification should be applied from the date of the change in the classification.

Disposal of Independent Foreign Operations

STANDARD

6.18 On disposal of an independent foreign operation, the accumulated amount of the exchange differences taken to the foreign currency translation reserve that relate to the foreign operation and to any monetary liability designated as a hedge of that operation shall be transferred out of the foreign currency translation reserve but shall remain within equity. The amount of the exchange differences shall not be taken to the statement of financial performance nor recognised in the statement of movements in equity.

COMMENTARY

6.19 The foreign currency translation reserve is to contain only exchange differences that relate to existing independent foreign operations and, when applicable, the monetary liabilities that are and have been designated a hedge of the net investment in the independent foreign operation.

6.20 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 foreign operation. A write-down of the carrying amount of a foreign operation does not constitute a disposal. Accordingly, no part of the foreign exchange gain or loss taken to the foreign currency translation reserve is reclassified at the time of a write-down.

6.21 Transfers between reserves are not to be reflected in the statement of movements in equity but in a note to the financial statements, as stated in paragraph 7.7 of FRS-2: *Presentation of Financial Reports*.

7 DISCLOSURES

STANDARD

7.1 The financial report shall include separate disclosure of:

(a) the accounting policies adopted in translating foreign currency transactions and in translating the financial statements of foreign operations;

(b) the net exchange difference included in the statement of financial performance;

(c) foreign currency translation reserve movements in the period showing separately:

- **(i) the gross amounts recognised as a result of hedging foreign currency liabilities against net investments in independent foreign operations; and**
- **(ii) the net exchange difference arising from the translation of the financial statements of foreign operations, other than that required to be disclosed by (i) above;**

(d) the balance of the foreign currency translation reserve as a subclassification of equity;

(e) the amounts, in aggregate for each foreign currency, of monetary assets and monetary liabilities denominated in a foreign currency in the case of:

- **(i) current assets and current liabilities, or balances reported in the broad order of their liquidity, to the extent that they are not hedged; and**
- **(ii) non-current assets and non-current liabilities, to the extent that they are not hedged to a date at least twelve months after balance date; and**

(f) **the effect of translating the opening cash balance and the cash flows during the accounting period at rates different from the exchange rate used to translate the closing cash balance. The effect shall be reported, in the statement of cash flows, as part of the reconciliation of the change in cash in the period.**

COMMENTARY

7.2 Information required in paragraph 7.1(e) is in aggregate for each foreign currency, separated into amounts payable and receivable. This disclosure is intended to provide an indication of the exposure of entities at balance date to the risks of changes in foreign exchange rates. Entities are encouraged to supplement this disclosure with an outline of their policies in respect of hedging monetary items and other matters relevant to an assessment of entities' exposure to movements in exchange rates.

STANDARD

7.3 When the reporting currency is different from the currency of the country in which the entity reporting is domiciled, the reason for using a different currency shall be disclosed.

7.4 The reason for any change in the reporting currency shall be disclosed.

7.5 When there is a change in the classification of a foreign operation, the financial report shall separately disclose:

(a) the nature of the change in classification;

(b) the reason for the change;

(c) the quantified impact on the foreign currency translation reserve of the change in classification; and

(d) the quantified impact on the statement of financial performance for the current period had the change in the classification occurred at the beginning of the current period.

8 TRANSITIONAL PROVISION

STANDARD

8.1 Comparative figures for prior periods are not permitted to be adjusted for the effect of changing accounting policy in accordance with paragraph 6.5(b) in the first period of application of this Standard.

COMMENTARY

8.2 This Standard requires entities to change their accounting policy in accordance with paragraph 6.5(b) in the first period of application. This change of policy is not to be given retroactive effect. Disclosure of the effect of the change in policy should be made in accordance with FRS-1: *Disclosure of Accounting Policies*.

APPENDIX 1

Comparison of FRS-21 with International and Australian Accounting Standards

This comparison appendix, which was prepared as at 31 July 1997, deals only with significant differences in the standards. It is produced for information purposes only and does not form part of the standards in FRS-21. The International Accounting Standard referred to in this Appendix was promulgated by the International Accounting Standards Committee.

The International and Australian accounting standards comparable with FRS-21 are:

- IAS-21 (1993): *The Effects of Changes in Foreign Exchange Rates*;
- AASB 1012 (1988): *Foreign Currency Translation*; and
- AAS 20 (1987): *Foreign Currency Translation*.

The following summarises the significant differences in the above standards and FRS-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates*.

Hedging

The Australian standards deal with the hedging of foreign currency transactions, but neither FRS-21 nor IAS-21 deals with hedging other than hedging of a net investment in an independent foreign operation. New Zealand reporting requirements for hedging are contained in SSAP-21: *Accounting for the Effects of Changes in Foreign Currency Exchange Rates* which has authoritative support within the accounting profession in New Zealand.

Exchange Differences on Monetary Items

All the standards require exchange differences on monetary items, excluding certain hedged positions, to be recognised in the statement of financial performance. FRS-21 requires this without exception. However, IAS-21 and the Australian standards contain the following exceptions:

- IAS-21 permits, as an alternative treatment, the capitalisation of exchange differences (as part of the cost of the related asset) in defined circumstances. These circumstances cover differences arising in respect of liabilities not able to be settled, that finance the acquisition of an asset, when such a difference is the result of a significant movement in valuation of a currency not able to be hedged. The exceptions of IAS-21 are subject to a lower of replacement cost and recoverable amount limitation.
- The Australian standards require the capitalisation of exchange differences which relate directly to, or can be reasonably attributed to, the cost of

acquiring defined qualifying assets. These standards apply a recoverable amount constraint, but not a replacement cost restraint.

Exchange Differences on Revalued Items

When an asset is revalued, FRS-21 states explicitly that the exchange difference arising at the time of the revaluation is part of the revaluation and should follow the treatment of the asset revaluation. IAS-21, while requiring measurement of the exchange difference in the same manner, does not include specific requirements about the treatment of the exchange difference.

Recognition of Exchange Differences on Hedging an Investment in an Independent Foreign Operation

FRS-21 and the Australian standards require exchange differences on transactions that hedge a net investment in an independent foreign operation to be recognised in the foreign currency translation reserve in the consolidated financial statements, to the extent that exchange differences arising from the liability are offset by exchange differences on the net investment. FRS-21 requires these exchange differences to be recognised in the statement of movements in equity. Excess exchange differences are to be recognised in the statement of financial performance. IAS-21 does not contain this limitation and simply requires all exchange differences on the hedge to be classified as equity.

Classification of Exchange Differences on an Investment in an Independent Foreign Operation

FRS-21 and the Australian standards specify that exchange differences on a net investment in an independent foreign operation recognised in equity are to be taken to the foreign currency translation reserve. FRS-21 requires these exchange differences to be recognised in the statement of movements in equity. IAS-21 simply requires the classification of such exchange differences as equity.

Treatment of Exchange Differences in the Foreign Currency Translation Reserve on Disposal of an Investment in an Independent Foreign Operation

FRS-21 requires exchange differences in the foreign currency translation reserve that relate to an investment in an independent foreign operation no longer held, to be transferred out of the foreign currency translation reserve but remain in equity. The differences shall not be taken to the statement of financial performance nor recognised in the statement of movements in equity. IAS-21 requires such exchange differences to be recognised in the statement of financial performance. AASB 1012 and AAS 20 are silent on the treatment of reserves on disposal of an independent foreign operation. The applicable Australian standards for treatment on disposal are AAS 24: *Consolidated Financial Reports* and AASB 1024: *Consolidated Accounts*. These standards specify that the gain or loss recognised (by the parent entity) on the sale of the ownership interest in the foreign operation is, in preparing the consolidated financial statements, to be adjusted by the net

post-acquisition movement to the date of sale in the retained profits or accumulated losses and reserves of the foreign operation. In addition, AASB 1018: *Profit and Loss Accounts* does not permit the inclusion of transfers from reserves in the statement of financial performance for the financial year.

Required Disclosure on Reclassification

When a reclassification occurs, FRS-21 requires disclosure of the effect on the current period's profit as if the reclassification occurred at the start of the period.

IAS-21 requires instead disclosure of the effect on profit for the prior period for which comparative figures are presented, as if the reclassification occurred at the start of the prior period.

The Australian standards do not prescribe disclosures in respect of reclassified foreign operations.

Foreign Operation Maintained in Hyperinflationary Economy

IAS-21 and AAS 20 include treatments in respect of the translation of the financial statements of a foreign operation reporting in the currency of a hyperinflationary economy. IAS-21 requires restatement in accordance with IAS-29: *Financial Reporting in Hyperinflationary Economies*. In respect of independent foreign operations, AAS 20 recommends the revaluation of all non-monetary, non-current assets prior to translation. FRS-21 and AASB 1012 are both silent on this matter.

APPENDIX 2

Illustration of Application of Paragraphs 5.3(c), 5.4(b) and 6.14

This appendix provides illustrations of the application of paragraphs 5.3(c), 5.4(b) and 6.14. It is produced for information purposes only and does not form part of the standards in FRS-21.

Example 1: Illustration of application of paragraphs 5.3(c) and 5.4(b)

Revaluation of overseas property held by a New Zealand entity.

Paragraph 5.3(c) states:

> "(c) non-monetary items that are carried at other than historical cost and measured in a foreign currency shall be translated using the spot rate that existed when the values of those non-monetary items were determined."

Paragraph 5.4(b) states:

> "(b) exchange differences arising on non-monetary items at the date of revaluation shall be accounted for in the same manner as the change in the value of the non-monetary item."

Assume:

- Purchase of land for $100,000 in foreign currency (FC) when the exchange rate $1FC = $1NZ.
- End of year 1, the property is not revalued and the exchange rate is $1FC = $0.90NZ.
- End of year 2, the property is revalued to $150,000FC and the exchange rate is $1FC = $0.80NZ.

At the purchase date the cost of the land is $100,000. At the end of the first year, the land is not revalued and, as it is a non-monetary asset, it is translated at the spot rate at the transaction date (FRS-21 paragraph 5.3(b)). The carrying value therefore remains at $100,000.

At the end of the second year the land is revalued to its fair value of $150,000FC and translated at the spot rate when the value is determined (i.e. at $1FC = $0.80NZ). Hence, the carrying amount of the land is now $120,000NZ, and an asset revaluation reserve of $20,000 is created (FRS-21 paragraph 5.4(b)).

Example 2: Illustration of application of paragraphs 5.3(c), 5.4(b), and 6.14

Revaluation of property held by an integrated foreign operation.

Paragraph 6.14 states:

> "The financial statements of an integrated foreign operation shall be translated in the same way as if the underlying transactions had been entered into by the entity reporting."

Assume:

- The same facts as in Example 1, except that the transaction is undertaken by an integrated subsidiary.

The following table shows the consolidation worksheet for both year 1 (acquisition) and year 2 (revaluation). All debit items are positive numbers and all credit items are negative numbers. In year 1, the financial statements of the integrated foreign subsidiary are translated at the transaction spot rate (FRS-21 paragraphs 5.1 and 6.14). The consolidation adjustment eliminates the investment in the subsidiary against the equity (capital) of the subsidiary acquired.

In year 2, the land has been revalued in the books of the foreign subsidiary (column (a)). The subsidiary's financial statements are translated using the spot rates at the times that the carrying amounts were determined. This yields a foreign exchange difference of $20,000 (column (c)) which would normally be recognised in the statement of financial performance for the period. FRS-21 paragraphs 5.4(b) and 6.14 require this exchange difference to be accounted for in the same manner as the change in value of the non-monetary item.

Note that the final result in Example 2 is the same as if the New Zealand parent company had directly purchased the overseas land (Example 1), hence the purpose of paragraphs 5.3(c) and 5.4(b) in FRS-21.

Example 2

Year 1: Acquisition

	(a) Foreign Subsidiary FC$'000	(b) Translation Rates	(c) Foreign Subsidiary NZ$'000	(d) NZ Parent NZ$'000	(e) Sub-total NZ$'000	(f) Consolidation Adjustment NZ$'000	(g) Group Statement NZ$'000
Capital	(100)	1.00	(100)	(100)	(200)	100	(100)
Land	100	1.00	100	0	100		100
Investment in Subsidiary	0		0	100	100	(100)	0
	100		100	100	200	0	100

Year 2: Revaluation

	(a) Foreign Subsidiary FC$'000	(b) Translation Rates	(c) Para 5.3(c) adjustment NZ$'000	(d) NZ Parent NZ$'000	(e) Sub-total NZ$'000	(f) Consolidation Adjustment NZ$'000	(g) Group Statement NZ$'000
Capital	(100)	1.00	(100)	(100)	(200)	100	(100)
Foreign exch difference			20		20	(20)	0
Asset revaln reserve	(50)	0.80	(40)		(40)	20	(20)
	(150)		(120)	(100)	(220)	100	(120)
Land	150	0.80	120		120		120
Investment in Subsidiary	0		0	100	100	(100)	0
	150		120	100	220	0	120

HISTORY

Previously issued accounting standards superseded by this Financial Reporting Standard:

SSAP-21 *Accounting for the Effects of Changes in Foreign Currency Exchange Rates (issued April 1988 and effective for periods beginning on or after 1 July 1988), paragraphs 5.1, 5.2, 5.4, 5.7 and 5.9 to 5.13(a) to (c) and the relevant discussion and definition paragraphs.*

(Next page is **2** - 245)