PBE IPSAS 4: THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

Version 1: 2014

Effective Periods Beginning
1 July 2014

An entity's **functional currency** is the currency of the primary economic environment in which it operates.

Determine **functional currency** of each entity within a group - currency of primary economic environment in which the individual entity operates.

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When determining the appropriate **functional currency**, the following factors are considered:

- Currency that revenue is raised from, such as taxes, grants and fines.
- Currency influencing sales prices for goods and services.
- Currency of country whose competitive forces and regulations determine sale prices.
- Currency mainly influencing input costs.

No clear answer

Consider currency in which funds / receipts:
- From financing activities are generated.
- From operating activities are retained.

No clear answer

Consider:

- Level of autonomy from parent company (reporting entity).
- If not autonomous, functional currency is the same as parent.

Clear answer

FUNCTIONAL CURRENCY ESTABLISHED

FOREIGN CURRENCY TRANSACTIONS

Initial recognition
Spot rate at transaction date.

Subsequent measurement

Monetary items

- Closing rate at reporting date.
- Gain or loss recognised in surplus or deficit.

Monetary items are units of currency held and assets and liabilities to be received/paid in a fixed or determinable amount of money.

Non- monetary items

- Rate at transaction date (if item at historical cost).
- Rate at revaluation date (if item carried at revalued amount).

Translation gains or losses on asset/liability recognised in surplus or deficit.

Consolidation of foreign entities and translation of financial statements to a presentation currency

Translation method:

- Assets & Liabilities - closing rate.
- Revenue and expenses - rate at transaction date.
- Resulting exchange differences recognised in other comprehensive revenue and expense in Foreign Currency Translation Reserve.

Loan forming part of net investment in subsidiary

Exchange differences are recognised in other comprehensive revenue and expense on consolidation only.

In the separate or individual financial statements, exchange differences are recognised in surplus or deficit.

General principle

Forex gain or loss to surplus or deficit.

- **Except** where gain or loss on non-monetary item recognised in other comprehensive revenue and expense.
  - Then foreign exchange gain or loss recognised in other comprehensive revenue and expense.

Key principles:

- No need to present Financial Statements in functional currency.
- Accounting records must be kept in functional currency.
- A group does not have a functional currency. Functional currency is assessed separately for each entity in the group.

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