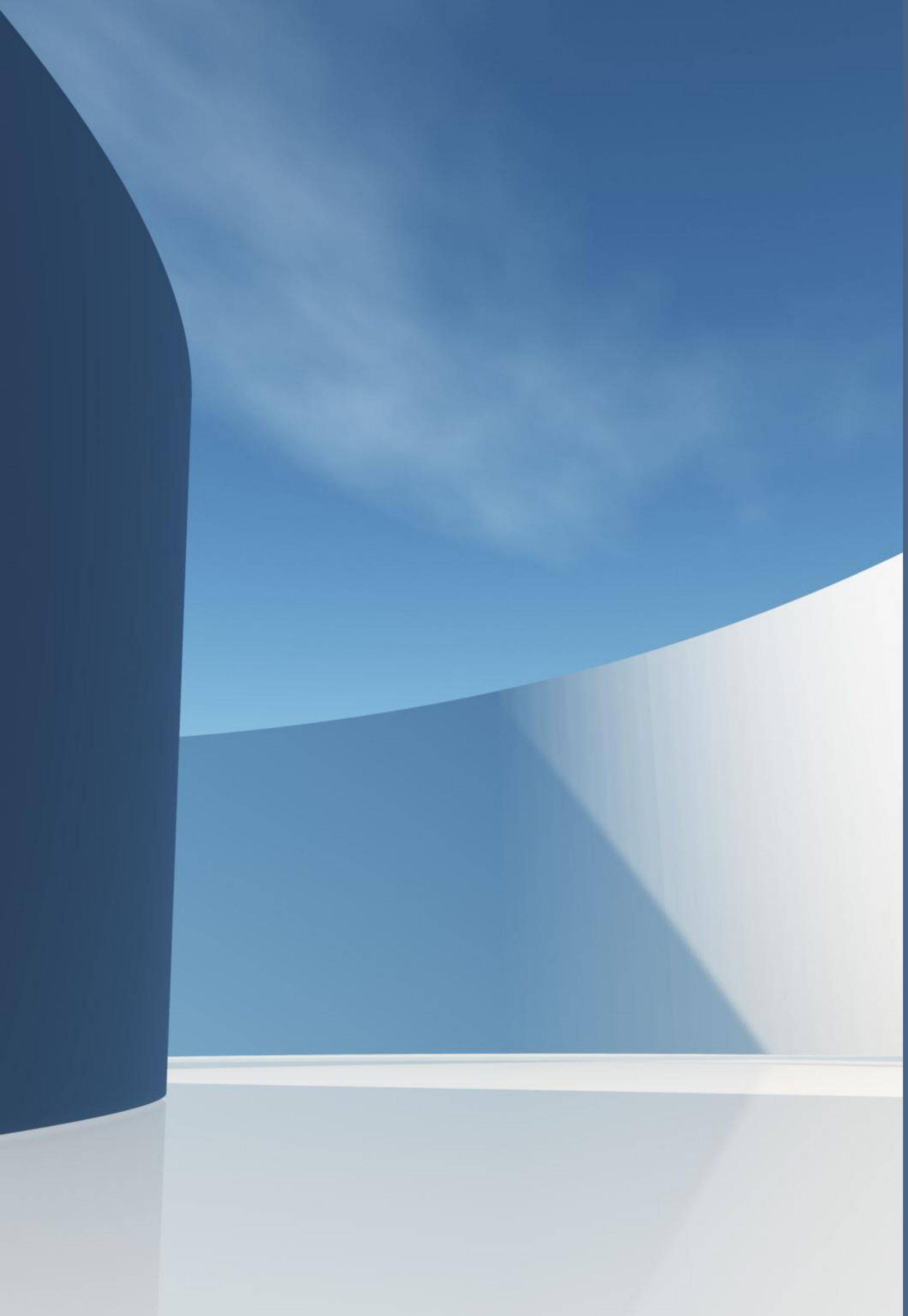

FINANCIAL REPORTING

IAS 21: The effects of changes in foreign exchange rates

OBJECTIVE OF THE STANDARD

The objective of this standard is to prescribe how to include foreign currency transactions in the financial statements of an entity and how to translate financial statements into a presentation currency.

Foreign activities may include an entity;

- Transacting in foreign currency
- Having foreign operations

An entity may present its financial statements in a foreign currency

SCOPE OF THE STANDARD

Standard shall be applied in;

- accounting for transactions and balances in foreign currencies except for derivative transactions under the scope of IFRS 9: financial instruments;
- translating the results and financial position of foreign operations that are included in the financial statements of the entity; and
- translating an entity’s results and financial position into a presentation currency.

KEY CONCEPTS DEFINED

Foreign currency: A currency other than the functional currency of the entity.

Functional currency: the currency of the primary economic environment in which the entity operates.

Factors considered when determining a functional currency

Primary factors

- The currency that mainly influences sales prices for goods and services.
- The currency of the country whose competitive forces and regulations mainly determine the sales price of goods and services.
- The currency that mainly influences labour, materials and other costs of providing goods and services.
- The currency in terms of which entity earns its revenue and incurs costs.
- The currency in which selling price of the goods or services supplied by the entity is denominated.

Secondary factors (incase primary factors are inconclusive)

- The currency in which funds from financing activities are generated.
- The currency in which receipts from operating activities are retained.

KEY CONCEPTS CONT'D

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

Exchange rate: The ratio of exchange for two currencies.

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

Spot exchange rate: The exchange rate for immediate delivery or the rate at the date the transaction takes place. Sometimes referred to as the *historic rate*.

Closing rate: The spot exchange rate at the end of the reporting period.

Average rate: Average rate throughout the accounting period.

ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS

Initial measurement of foreign currency transactions

An entity should translate these transactions using the spot rate at the date of the transaction. An average rate may be used if it does not fluctuate materially during the accounting period.

Subsequent measurement of foreign currency transactions

- **Settlement transactions**

When a foreign currency monetary item is settled (i.e., payment or receipt occurs during the reporting period), the settlement is translated at the date the payment/receipt occurs using the historic rate prevailing on that date.

If this rate is different from the initial transaction rate, exchange differences arise, and they are recognized in the statement of profit or loss.

- **Outstanding (closing) items at each reporting date**

At the reporting date, unsettled foreign currency items being assets or liabilities shall be recognized in the statement of financial position. The rate at which such items are translated depends on whether they are monetary or non-monetary.

- Monetary items are translated at a closing rate (the rate at the balance sheet date) with exchange differences recognized in profit or loss.
- Non-monetary items measured at historical cost in a foreign currency are translated at the historic rate (exchange rate at the date of the transaction) hence no exchange differences arise.
- Non-monetary items measured at fair value in a foreign currency are translated using the exchange rate at the date the fair value was measured and resultant exchange gains taken to other comprehensive income.

ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS

Monetary items: units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. In other words, they are cash or items that can be easily converted into cash such as receivables, payables, loans.

Non-monetary items: items that give no right to receive or deliver cash such as items of PPE, inventory, intangible assets, among others.

If a gain or loss in value of a non-monetary item is recognized in other comprehensive income, any exchange component of that gain or loss shall also be recognized in other comprehensive income and the reverse is true for non-monetary items whose gain or loss in value is recognized in profit or loss.

Exchange difference in profit or loss are disclosed within other operating income/operating expense if they relate to trading transactions and they are disclosed within interest receivable or similar income/finance costs if they relate to non trading transactions.

Change in a functional currency

When an entity changes a functional currency, the entity shall apply the translation procedures prospectively from the date of change.

Translation to the presentation currency

An entity may prepare it financial statements in a currency different from its functional currency. If it so happens, the entity must translate its results (financial statements) into the presentation currency. The following procedures are followed;

ACCOUNTING FOR FOREIGN CURRENCY TRANSACTIONS

- Assets and liabilities are translated at the closing rate (rate at the balance sheet date).
- Incomes, expenses and other comprehensive income are translated at the spot rates at the date of the transactions. However, for practical reasons, an average rate is used if the exchange rates don’t fluctuate significantly. If they do, then an average rate is inappropriate.
- The resulting exchange differences are recognized in other comprehensive income. These result from; translating incomes and expenses at exchange rates at the date of the transactions and assets and liabilities at the closing rate and; translating the opening net assets at a closing rate different from the previous closing rate.

DISCLOSURES

- The details about the functional currency and the basis used for the determination of functional currency.
- Any amount of exchange gains or loss recognized in the statement of profit or loss in the current year.
- Any amount exchange gains or loss recognized in the statement of other comprehensive income in the current year.
- If the functional currency and presentation currency of the entity is different, it should be disclosed with the reasons for the difference.
- In case of a change in the functional currency, the reasons for the change along with related events and conditions.

November 2023 Qn 1 (1)

May 2023 Qn 3 (2)

March 2021 question 1 (3)

June 2022 question 2 (1)

December 2020 question 4