# IPSAS 4

# The Effects of Changes in Foreign Exchange Rates


***Acknowledgment***

This International Public Sector Accounting Standard is drawn primarily from International Accounting Standard IAS 21, *The Effects of Changes in Foreign Exchange Rates* published by the International Accounting Standards Committee (IASC). The International Accounting Standards Board (IASB) and the International Accounting Standards Committee Foundation (IASCF) were established in 2001 to replace the IASC. The International Accounting Standards (IASs) issued by the IASC remain in force until they are amended or withdrawn by the IASB. Extracts from IAS 21 are reproduced in this publication of the Public Sector Committee of the International Federation of Accountants with the permission of IASB.

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# IPSAS 4

**May 2000**

# The Effects of Changes in Foreign Exchange Rates

**CONTENTS**

# INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD IPSAS 4

# THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

*The standards, which have been set in bold italic type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the "Preface to International Public Sector Accounting Standards." International Public Sector Accounting Standards are not intended to apply to immaterial items.*

## OBJECTIVE

An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In order to include foreign currency transactions and foreign operations in the financial statements of an entity, transactions must be expressed in the entity's reporting currency and the financial statements of foreign operations must be translated into the entity's reporting currency.

The principal issues in accounting for foreign currency transactions and foreign operations are to decide which exchange rate to use and how to recognize in the financial statements the financial effect of changes in exchange rates.

## SCOPE

1. ***An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard:***

   ***(a) in accounting for transactions (including the subsequent reporting of monetary and non-monetary items) in foreign currencies; and***

   ***(b) in translating the financial statements of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation or by the equity method.***

2. This Standard does not deal with hedge accounting for foreign currency items other than the classification of exchange differences arising on a foreign currency liability accounted for as a hedge of a net investment in a foreign entity. Accordingly, entities may apply relevant national accounting standards dealing with hedge accounting.

3. Guidance on other aspects of hedge accounting, including the criteria to use hedge accounting, can be found in International Accounting Standard IAS 39, *Financial Instruments: Recognition and Measurement*.

4. ***This Standard applies to all public sector entities other than Government Business Enterprises.***

5. Government Business Enterprises (GBEs) are required to comply with International Accounting Standards (IASs) issued by the International Accounting Standards Committee. The Public Sector Committee's Guideline No. 1 *Financial Reporting by Government Business Enterprises*

notes that IASs are relevant to all business enterprises, regardless of whether they are in the private or public sector. Accordingly, Guideline No. 1 recommends that GBEs should present financial statements that conform, in all material respects, to IASs.

6. This Standard does not specify the currency in which an entity presents its financial statements. However, an entity 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.

7. This Standard does not deal with the restatement of an entity's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

8. This Standard deals with the presentation of revenue and expenses arising from transactions in a foreign currency and translating the financial statements of a foreign operation. It does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (see International Public Sector Accounting Standard IPSAS 2 *Cash Flow Statements*).

## DEFINITIONS

***9. The following terms are used in this Standard with the meanings specified:***

***<u>Accrual basis</u> means a basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.***

***<u>Assets</u> are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.***

***<u>Associate</u> is an entity in which the investor has significant influence and which is neither a controlled entity nor a joint venture of the investor.***

***<u>Cash</u> comprises cash on hand and demand deposits.***

***<u>Cash equivalents</u> are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.***

***<u>Cash flows</u> are inflows and outflows of cash and cash equivalents.***

***<u>Closing rate</u> is the spot exchange rate at the reporting date.***

***Consolidated financial statements*** ***are the financial statements of an economic entity presented as those of a single entity.***

***Contributions from owners*** ***means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:***

***(a)*** ***conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or***

***(b)*** ***can be sold, exchanged, transferred or redeemed.***

***Control*** ***is the power to govern the financial and operating policies of another entity so as to benefit from its activities.***

***Controlled entity*** ***is an entity that is under the control of another entity (known as the controlling entity).***

***Controlling entity*** ***is an entity that has one or more controlled entities.***

***Distributions to owners*** ***means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.***

***Economic entity*** ***means a group of entities comprising a controlling entity and one or more controlled entities.***

***Equity method*** ***is a method of accounting whereby the investment is initially recorded at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets/equity of the investee. The statement of financial performance reflects the investor's share of the results of operations of the investee.***

***Exchange difference*** ***is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.***

***Exchange rate*** ***is the ratio for exchange of two currencies.***

***Expenses*** ***are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.***

***Extraordinary items*** ***are revenue or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the entity, are not expected to recur frequently or regularly and are outside the control or influence of the entity.***

***Fair value*** ***is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.***

***Financing activities*** ***are activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.***

***Foreign currency*** ***is a currency other than the reporting currency of an entity.***

***Foreign entity*** ***is a foreign operation, the activities of which are not an integral part of those of the reporting entity.***

***Foreign operation*** ***is a controlled entity, associate, joint venture or branch of the reporting entity, the activities of which are based or conducted in a country other than the country of the reporting entity.***

***Government Business Enterprise*** ***means an entity that has all the following characteristics:***

***(a) is an entity with the power to contract in its own name;***

***(b) has been assigned the financial and operational authority to carry on a business;***

***(c) sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;***

***(d) is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and***

***(e) is controlled by a public sector entity.***

***Investing activities*** ***are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.***

***Joint venture*** ***is a binding arrangement whereby two or more parties are committed to undertake an activity which is subject to joint control.***

***Liabilities*** ***are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.***

***Minority interest*** ***is that part of the net surplus (deficit) and of net assets/equity of a controlled entity attributable to interests which are not owned, directly or indirectly through controlled entities, by the controlling entity.***

***Monetary items*** ***are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.***

***Net assets/equity*** ***is the residual interest in the assets of the entity after deducting all its liabilities.***

***Net investment in a foreign entity*** ***is the reporting entity's share in the net assets/equity of that entity.***

***Net surplus/deficit*** ***comprises the following components:***

***(a) surplus or deficit from ordinary activities; and***

***(b) extraordinary items.***

***Operating activities* are the activities of the entity that are not investing or financing activities.**

***Ordinary activities* are any activities which are undertaken by an entity as part of its service delivery or trading activities. Ordinary activities include such related activities in which the entity engages in furtherance of, incidental to, or arising from these activities.**

***Proportionate consolidation* is a method of accounting and reporting whereby a venturer's share of each of the assets, liabilities, revenue and expenses of a jointly controlled entity is combined on a line-by-line basis with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.**

***Reporting currency* is the currency used in presenting the financial statements.**

***Reporting date* means the date of the last day of the reporting period to which the financial statements relate.**

***Revenue* is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.**

***Surplus/deficit from ordinary activities* is the residual amount that remains after expenses arising from ordinary activities have been deducted from revenue arising from ordinary activities.**

### Economic Entity

10. The term "economic entity" is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.

11. Other terms sometimes used to refer to an economic entity include "administrative entity," "financial reporting entity," "consolidated entity" and "group."

12. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

### Future Economic Benefits or Service Potential

13. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity's objectives but which do not directly generate net cash inflows are often described as embodying "service potential." Assets that are used to generate net cash inflows are often described as embodying "future economic benefits." To encompass all the purposes to which assets may be put, this Standard uses the term "future economic benefits or service potential" to describe the essential characteristic of assets.

### Government Business Enterprises

14. Government Business Enterprises (GBEs) include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. International Public Sector Accounting Standard IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities* provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.

### Net Assets/Equity

15. "Net assets/equity" is the term used in this Standard to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

## FOREIGN CURRENCY TRANSACTIONS

## Initial Recognition

16. A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an entity either:

    (a) buys or sells goods or services whose price is denominated in a foreign currency;

    (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency;

    (c) becomes a party to an unperformed foreign exchange contract; or

    (d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

***17. A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.***

18. The exchange rate at the date of the transaction is often referred to as the spot rate. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

19. Exchange rate changes may have an impact on cash or cash equivalents held or due in a foreign currency. The presentation of such exchange differences is dealt with in IPSAS 2. Although these changes are not cash flows, the effect of exchange rate changes on cash or cash equivalents held or due in a foreign currency are reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. These amounts are presented separately from cash flows from operating, investing and financing activities and include the differences, if any, had those cash flows been reported at end-of-period exchange rates.

## Reporting at Subsequent Reporting Dates

***20. At each reporting date:***

***(a) foreign currency monetary items should be reported using the closing rate;***

***(b) non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction; and***

***(c) non-monetary items which are carried at fair value denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.***

21. The carrying amount of an item is determined in accordance with the relevant International Public Sector Accounting Standards. For example, certain financial instruments and property, plant and equipment may be measured at fair value or at historical cost. Whether the carrying amount is determined based on historical cost or fair value, the amounts so determined for foreign currency items are then reported in the reporting currency in accordance with this Standard.

## Recognition of Exchange Differences

22. Paragraphs 24 to 28 set out the accounting treatment required by this Standard in respect of exchange differences on foreign currency transactions. These paragraphs include the benchmark treatment for exchange differences that result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of assets invoiced in a foreign currency. The allowed alternative treatment for such exchange differences is set out in paragraph 31.

23. This Standard does not deal with hedge accounting for foreign currency items other than the classification of exchange differences arising on a foreign currency liability accounted for as a hedge of a net investment in a foreign entity. Guidance in relation to other aspects of hedge accounting, including the criteria to use hedge accounting, can be found in IAS 39.

***24. Exchange differences arising on the settlement of monetary items or on reporting an entity's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous***

***financial statements, should be recognized as revenue or as expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraphs 27 and 29.***

25. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognized in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognized in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.

26. The treatment of foreign currency exchange rate changes in a cash flow statement is described in paragraph 19.

### Net Investment in a Foreign Entity

***27. Exchange differences arising on a monetary item that, in substance, forms part of an entity's net investment in a foreign entity should be classified as net assets/equity in the entity's financial statements until the disposal of the net investment, at which time they should be recognized as revenue or as expenses in accordance with paragraph 55.***

28. An entity may have a monetary item that is receivable from, or payable to, a foreign entity. 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's net investment in that foreign entity. Such monetary items may include long-term receivables or loans.

***29. Exchange differences arising on a foreign currency liability accounted for as a hedge of an entity's net investment in a foreign entity should be classified as net assets/equity in the entity's financial statements until the disposal of the net investment, at which time they should be recognized as revenue or as expenses in accordance with paragraph 55.***

### Allowed Alternative Treatment

30. The benchmark treatment for exchange differences dealt with in paragraph 31 is set out in paragraph 24.

***31. Exchange differences may result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset invoiced in a foreign currency. Such exchange differences should be included in the carrying amount of the related asset.***

32. Exchange differences are not included in the carrying amount of an asset when the entity is able to settle or hedge the foreign currency liability arising on the acquisition of the asset. However, exchange losses are part of the directly attributable costs of the asset when the liability cannot be settled and there is no practical means of hedging, for example when, as a result of

exchange controls, there is a delay in obtaining foreign currency. Therefore, under the allowed alternative treatment, the cost of an asset invoiced in a foreign currency is regarded as the amount of reporting currency that the entity ultimately has to pay to settle its liabilities arising directly on the recent acquisition of the asset.

## FINANCIAL STATEMENTS OF FOREIGN OPERATIONS

### Classification of Foreign Operations

33. The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to the reporting entity. For this purpose, foreign operations are classified as either "foreign operations that are integral to the operations of the reporting entity" or "foreign entities."

34. A foreign operation that is integral to the operations of the reporting entity carries on its activities as if it were an extension of the reporting entity's operations. For example, a department of defense might have a number of overseas bases which conduct activities on behalf of a national government. The defense bases might conduct their activities substantially in the reporting currency of the reporting entity. For example, military personnel may be paid in the reporting currency and receive only a small allowance in local currency. Purchases of supplies and equipment might be largely obtained via the reporting entity with purchases in local currency being kept to a minimum. Another example would be an overseas campus of a public university which operates under the management and direction of the domestic campus. In such cases, a change in the exchange rate between the reporting currency and the currency in the country of foreign operation has an almost immediate effect on the reporting entity's cash flow from operations. Therefore, the change in the exchange rate affects the individual monetary items held by the foreign operation rather than the reporting entity's net investment in that operation.

35. In contrast, a foreign entity accumulates cash and other monetary items, incurs expenses, generates revenue and perhaps arranges borrowings, all substantially in its local currency. It may also enter into transactions in foreign currencies, including transactions in the reporting currency. Some examples of government-owned foreign entities which may operate independently of other government agencies include tourist offices, petroleum exploration companies, trade boards and broadcasting operations. Such entities may be established as Government Business Enterprises. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the foreign entity or the reporting entity. The change in the exchange rate affects the reporting entity's net investment in the foreign entity rather than the individual monetary and non-monetary items held by the foreign entity.

36. The following are indications that a foreign operation is a foreign entity rather than a foreign operation that is integral to the operations of the reporting entity:

    (a) while the reporting entity may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting entity;

    (b) transactions with the reporting entity are not a high proportion of the foreign operation's activities;

    (c) the activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting entity;

    (d) costs of labor, material and other components of the foreign operation's products or services are primarily paid or settled in the foreign operation's local currency rather than in the reporting currency;

    (e) the foreign operation's revenues are mainly in currencies other than the reporting currency; and

    (f) cash flows of the reporting entity are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation.

    It is not necessary for all these indicators to be present in order to classify a foreign operation as a foreign entity. The appropriate classification for each operation can, in principle, be established from factual information related to the indicators listed above. In some cases, the classification of a foreign operation as either a foreign entity or an integral operation of the reporting entity may not be clear, and judgment is necessary to determine the appropriate classification.

## Foreign Operations that are Integral to the Operations of the Reporting Entity

***37. The financial statements of a foreign operation that is integral to the operations of the reporting entity should be translated using the standards and procedures in paragraphs 16 to 32 as if the transactions of the foreign operation had been those of the reporting entity itself.***

38. The individual items in the financial statements of the foreign operation are translated as if all its transactions had been entered into by the reporting entity itself.

39. The cost and depreciation of property, plant and equipment is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value, using the rate that existed on the date of the valuation. The cost of inventories is translated at the exchange rates that existed when those costs were incurred. The realizable value of an asset is translated using the exchange rate that existed when the net realizable value was determined. For example, when the net realizable value of an item of inventory is determined in a foreign currency, that value is translated using the exchange rate at the date as at which the net realizable value is

determined. The rate used is therefore usually the closing rate. An adjustment may be required to reduce the carrying amount of an asset in the financial statements of the reporting entity to its net realizable value even when no such adjustment is necessary in the financial statements of the foreign operation. Alternatively, an adjustment in the financial statements of the foreign operation may need to be reversed in the financial statements of the reporting entity.

40. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

## Foreign Entities

***41. In translating the financial statements of a foreign entity for incorporation in its financial statements, the reporting entity should use the following procedures:***

***(a) the assets and liabilities, both monetary and non-monetary, of the foreign entity should be translated at the closing rate;***

***(b) revenue and expense items of the foreign entity should be translated at exchange rates at the dates of the transactions, except when the foreign entity reports in the currency of a hyperinflationary economy, in which case revenue and expense items should be translated at the closing rate; and***

***(c) all resulting exchange differences should be classified as net assets/equity until the disposal of the net investment.***

42. Refer to paragraph 52 for a discussion of the restatement of financial statements of foreign entities that report in the currency of a hyperinflationary economy.

43. In translating the cash flows, that is the cash receipts and cash payments, of a foreign entity for incorporation in its cash flow statement, the reporting entity should comply with the procedures in IPSAS 2. IPSAS 2 requires that the cash flows of a foreign controlled entity should be translated at the exchange rates between the reporting currency and the foreign currency at the dates of the cash flows. IPSAS 2 also outlines the presentation of unrealized gains and losses arising from changes in foreign currency exchange rates on cash and cash equivalents held or due in a foreign currency.

44. For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period, is often used to translate revenue and expense items of a foreign operation.

45. The translation of the financial statements of a foreign entity results in the recognition of exchange differences arising from:

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

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

(c) other changes to net assets/equity in the foreign entity.

These exchange differences are not recognized as revenue or expenses for the period 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 foreign entity or the reporting entity. When a foreign entity 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.

46. Any goodwill arising on the acquisition of a foreign entity and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign entity are treated as either:

(a) assets and liabilities of the foreign entity and translated at the closing rate in accordance with paragraph 41; or

(b) assets and liabilities of the reporting entity 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 in accordance with paragraph 20(b).

47. The incorporation of the financial statements of a foreign entity in those of the reporting entity follows normal consolidation procedures, such as the elimination of balances and transactions within an economic entity (see IPSAS 6 and International Public Sector Accounting Standard IPSAS 8 *Financial Reporting of Interests in Joint Ventures*).

48. However, an exchange difference arising on a monetary item within an economic entity, whether short term or long term, cannot be eliminated against a corresponding amount arising on other balances within an economic entity because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of a reporting entity, such an exchange difference continues to be recognized as revenue or an expense or, if it arises from the circumstances described in paragraphs 27 and 29, it is classified as net assets/equity until the disposal of the net investment.

49. When the financial statements of a foreign entity are drawn up to a different reporting date from that of the reporting entity, the foreign entity often prepares, for purposes of incorporation in the financial statements of the reporting entity, statements as at the same date as the reporting entity. When it is impracticable to do this, IPSAS 6 allows the use of financial statements drawn up to a different reporting date provided that the difference is no greater than three months.

50. When there is a difference between the reporting date of the reporting entity and the foreign entity, the assets and liabilities of the foreign entity are translated at the exchange rate at the reporting date of the foreign entity.

51. Adjustments are made when appropriate for significant movements in exchange rates up to the reporting date of the reporting entity in accordance with IPSAS 6 and International Public Sector Accounting Standard IPSAS 7 *Accounting for Investments in Associates*.

***52. The financial statements of a foreign entity that reports in the currency of a hyperinflationary economy should be restated in accordance with the appropriate standards that address financial reporting in hyperinflationary economies, before they are translated into the reporting currency of the reporting entity. When the economy ceases to be hyperinflationary and the foreign entity discontinues the preparation and presentation of financial statements in accordance with the appropriate standards addressing financial reporting in hyperinflationary economies, it should use the amounts expressed in the measuring unit current at the date of discontinuation as the historical costs for translation into the reporting currency of the reporting entity.***

53. A hyperinflationary economy is one in which the loss of purchasing power of money is at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

54. Hyperinflation is indicated by characteristics of the economic environment of a country which include the following:

(a) the general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;

(b) the general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;

(c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;

(d) interest rates, wages and prices are linked to a price index; and

(e) the cumulative inflation rate over three years is approaching, or exceeds, 100%.

**Disposal of a Foreign Entity**

***55. On the disposal of a foreign entity, the cumulative amount of the exchange differences which have been deferred and which relate to that foreign entity should be recognized as revenue or as expenses in the same period in which the gain or loss on disposal is recognized.***

56. An entity may dispose of its interest in a foreign entity through sale, liquidation, repayment of contributed capital, or abandonment of all, or part

of, that entity. The payment of a dividend forms part of a disposal only when it constitutes a return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a foreign entity does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognized at the time of a write-down.

### Change in the Classification of a Foreign Operation

***57. When 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.***

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

59. When a foreign operation that is integral to the operations of the reporting entity is reclassified as a foreign entity, exchange differences arising on the translation of non-monetary assets at the date of the reclassification are classified as net assets/equity. When a foreign entity is reclassified as a foreign operation that is integral to the operation of the reporting entity, the translated amounts for non-monetary items at the date of the change are treated as the historical cost for those items in the period of change and subsequent periods. Exchange differences which have been deferred are not recognized as revenue or expenses until the disposal of the operation.

## ALL CHANGES IN FOREIGN EXCHANGE RATES

### Tax Effects of Exchange Differences

60. For reporting entities subject to income taxes, guidance on the treatment of tax effects associated with the gains and losses on foreign currency transactions and exchange differences arising on the translation of the financial statements of foreign operations can be found in International Accounting Standard IAS 12, *Income Taxes.*

## DISCLOSURE

***61. The entity should disclose:***

***(a) the amount of exchange differences included in the net surplus or deficit for the period;***

***(b) net exchange differences classified as a separate component of net assets/equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period; and***

***(c) the amount of exchange differences arising during the period which is included in the carrying amount of an asset in accordance with the allowed alternative treatment in paragraph 31.***

***62. When the reporting currency is different from the currency of the country in which the entity is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.***

***63. When there is a change in the classification of a significant foreign operation, an entity should disclose:***

***(a) the nature of the change in classification;***

***(b) the reason for the change;***

***(c) the impact of the change in classification on net assets/equity; and***

***(d) the impact on net surplus or deficit for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.***

***64. When goodwill and fair value adjustments arising on the acquisition of a foreign entity are recognized, an entity should disclose the method selected to translate those adjustments in accordance with paragraph 46.***

65. Disclosure is also encouraged of an entity's foreign currency risk management policy.

## TRANSITIONAL PROVISIONS

***66. On the first occasion that an entity applies this Standard, the entity should, except when the amount is not reasonably determinable, classify separately and disclose the cumulative balance, at the beginning of the period, of exchange differences deferred and classified as net assets/equity in previous periods.***

## EFFECTIVE DATE

***67. This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after 1 July 2001. Earlier application is encouraged.***

68. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

## COMPARISON WITH IAS 21

International Public Sector Accounting Standard IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*, is drawn primarily from International Accounting Standard IAS 21, *The Effects of Changes in Foreign Exchange Rates*. The main differences between IPSAS 4 and IAS 21 are as follows:

- Commentary additional to that in IAS 21 has been included in IPSAS 4 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 4 uses different terminology, in certain instances, from IAS 21. The most significant examples are the use of the terms "entity," "revenue," "statement of financial performance," "statement of financial position" and "net assets/equity" in IPSAS 4. The equivalent terms in IAS 21 are "enterprise," "income," "income statement," "balance sheet" and "equity."
- IPSAS 4 contains a different set of definitions of technical terms from IAS 21 (paragraph 9).
- IPSAS 4 paragraph 31 requires exchange differences arising from a severe devaluation or depreciation of a currency under certain circumstances to be capitalized in the related asset. IAS 21 contains the additional requirement that such capitalization cannot exceed the lower of the replacement cost and recoverable amount of the asset. The Committee intends to address this issue in a future Standard on impairment.