December 2005

IAS 21
Amendment

AMENDMENT TO INTERNATIONAL ACCOUNTING STANDARD

IAS 21 The Effects Of Changes In Foreign Exchange Rates

Net Investment in a Foreign Operation

International
Accounting Standards
Board®

Amendment to
International Accounting Standard 21

The Effects of Changes in Foreign Exchange Rates

Net Investment in a Foreign Operation

This Amendment to IAS 21 The Effects of Changes in Foreign Exchange Rates—*Net Investment in a Foreign Operation* is issued by the International Accounting Standards Board (IASB), 30 Cannon Street, London EC4M 6XH, United Kingdom.

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Amendment to IAS 21 *The Effects of Changes in Foreign Exchange Rates*

This document sets out amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates*. The amendments finalise proposals that were contained in Draft Technical Correction 1 Proposed Amendments to IAS 21 *Net Investment in a Foreign Operation* published in September 2005.

An entity shall apply the amendments in this document for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.

Net investment in a foreign operation

Paragraph 15A is added as follows.

15A The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 15 may be any subsidiary of the group. For example, an entity has two subsidiaries, A and B. Subsidiary B is a foreign operation. Subsidiary A grants a loan to Subsidiary B. Subsidiary A's loan receivable from Subsidiary B would be part of the entity's net investment in Subsidiary B if settlement of the loan is neither planned nor likely to occur in the foreseeable future. This would also be true if Subsidiary A were itself a foreign operation.

Recognition of exchange difference

Paragraph 33 is amended as follows (new text is underlined and deleted text is struck through).

33 When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 28. ~~Similarly, i~~<u>I</u>f such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements in accordance with paragraph 28. <u>If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's</u>

individual financial statements in accordance with paragraph 28. Such exchange differences are reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (ie financial statements in which the foreign operation is consolidated, proportionately consolidated or accounted for using the equity method). ~~However, a monetary item that forms part of the reporting entity's net investment in a foreign operation may be denominated in a currency other than the functional currency of either the reporting entity or the foreign operation. The exchange differences that arise on translating the monetary item into the functional currencies of the reporting entity and the foreign operation are not reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (ie they remain recognised in profit or loss).~~

Paragraph 58A is added as follows.

58A *Net Investment in a Foreign Operation* **(Amendment to IAS 21), issued in December 2005, added paragraph 15A and amended paragraph 33. An entity shall apply those amendments for annual periods beginning on or after 1 January 2006. Earlier application is encouraged.**

Approval of Amendment to IAS 21 by the Board

The amendment to International Accounting Standard 21 The Effects of Changes in Foreign Exchange Rates—*Net Investment in a Foreign Operation* was approved for issue by the fourteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
John T Smith	
Geoffrey Whittington	
Tatsumi Yamada	

Basis for Conclusions

The following paragraph is added to the rubric for the Basis for Conclusions on IAS 21.

Paragraph BC1 is amended and paragraphs BC25A–BC25F are added in relation to the amendment to IAS 21 issued in December 2005.

Paragraph BC1 is amended as follows (new text is underlined).

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 21 *The Effects of Changes in Foreign Exchange Rates* in 2003, and on the amendment to IAS 21 *Net Investment in a Foreign Operation* in December 2005. Individual Board members gave greater weight to some factors than to others.

After paragraph BC25 a heading and paragraphs BC25A–BC25F are added, as follows.

Net investment in a foreign operation

BC25A The principle in paragraph 32 is that exchange differences arising on a monetary item that is, in substance, part of the reporting entity's net investment in a foreign operation are initially recognised in a separate component of equity in the consolidated financial statements of the reporting entity. Among the revisions to IAS 21 made in 2003 was the provision of guidance on this principle that required the monetary item to be denominated in the functional currency of either the reporting entity or the foreign operation. The previous version of IAS 21 did not include such guidance.

BC25B The requirements can be illustrated by the following example. Parent P owns 100 per cent of Subsidiary S. Parent P has a functional currency of UK sterling. Subsidiary S has a functional currency of Mexican pesos. Parent P grants a loan of 100 US dollars to Subsidiary S, for which settlement is neither planned nor likely to occur in the foreseeable future. IAS 21 (as revised in 2003) requires the exchange differences arising on the loan to be recognised in profit or loss in the consolidated financial statements of Parent P, whereas those differences would be recognised initially in equity in the consolidated financial statements of Parent P, if the loan were to be denominated in sterling or Mexican pesos.

BC25C After the revised IAS 21 was issued in 2003, constituents raised the following concerns:

(a) It is common practice for a monetary item that forms part of an entity's investment in a foreign operation to be denominated in a currency that is not the functional currency of either the reporting entity or the foreign operation. An example is a monetary item denominated in a currency that is more readily convertible than the local domestic currency of the foreign operation.

(b) An investment in a foreign operation denominated in a currency that is not the functional currency of the reporting entity or the foreign operation does not expose the group to a greater foreign currency exchange difference than arises when the investment is denominated in the functional currency of the reporting entity or the foreign operation. It simply results in exchange differences arising in the foreign operation's individual financial statements and the reporting entity's separate financial statements.

(c) It is not clear whether the term 'reporting entity' in paragraph 32 should be interpreted as the single entity or the group comprising a parent and all its subsidiaries. As a result, constituents questioned whether the monetary item must be transacted between the foreign operation and the reporting entity, or whether it could be transacted between the foreign operation and any member of the consolidated group, ie the reporting entity or any of its subsidiaries.

BC25D The Board noted that the nature of the monetary item referred to in paragraph 15 is similar to an equity investment in a foreign operation, ie settlement of the monetary item is neither planned nor likely to occur in the foreseeable future. Therefore, the principle in paragraph 32 to recognise exchange differences arising on a monetary item initially in a separate component of equity effectively results in the monetary item being accounted for in the same way as an equity investment in the foreign operation when consolidated financial statements are prepared. The Board concluded that the accounting treatment in the consolidated financial statements should not be dependent on the currency in which the monetary item is denominated, nor on which entity within the group conducts the transaction with the foreign operation.

BC25E Accordingly, in 2005 the Board decided to amend IAS 21. The amendment requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised initially in a separate component of equity in the consolidated financial statements. This requirement applies irrespective of the currency of the monetary item and of whether the monetary item results from a transaction with the reporting entity or any of its subsidiaries.

BC25F The Board also proposed amending IAS 21 to clarify that an investment in a foreign operation made by an associate of the reporting entity is not part of the reporting entity's net investment in that foreign operation. Respondents to the exposure draft disagreed with this proposal. Many respondents said that the proposed amendment added a detailed rule that was not required because the principle in paragraph 15 was clear. In redeliberations, the Board agreed with those comments and decided not to proceed with that proposed amendment.

