

International Public Sector Accounting Standard

The Effects of Changes in Foreign Exchange Rates



**International Federation
of Accountants**

International Public Sector Accounting Standards Board
International Federation of Accountants
545 Fifth Avenue, 14th Floor
New York, New York 10017 USA

This International Public Sector Accounting Standard (IPSAS) was prepared by the International Public Sector Accounting Standards Board (IPSASB), an independent standard-setting body within the International Federation of Accountants (IFAC). The objective of the IPSASB is to serve the public interest by developing high quality accounting standards for use by public sector entities around the world in the preparation of general purpose financial statements. This will enhance the quality and transparency of public sector financial reporting and strengthen public confidence in public sector financial management.

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IPSAS 4—THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

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**INTERNATIONAL PUBLIC SECTOR ACCOUNTING
STANDARD 4—THE EFFECTS OF CHANGES IN FOREIGN
EXCHANGE RATES**

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International Public Sector Accounting Standard 4, “The Effects of Changes in Foreign Exchange Rates” (IPSAS 4) is set out in paragraphs 1-74 and the Appendix. All the paragraphs have equal authority. IPSAS 4 should be read in the context of its objective, the Basis for Conclusion (if any), and the “Preface to the International Public Sector Accounting Standards”. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1. International Public Sector Accounting Standard (IPSAS) 4, “The Effects of Changes in Foreign Exchange Rates”, replaces IPSAS 4, “The Effects of Changes in Foreign Exchange Rates” (issued May 2000), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

Reasons for Revising IPSAS 4

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 4 as a response to the International Accounting Standards Board’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 4, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 21, “The Effects of Changes in Foreign Exchange Rates” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 21 for a public sector specific reason; such variances are retained in this IPSAS 4 and are noted in the Comparison with IAS 21. Any changes to IAS 21 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 4.

Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 4 are described below.

Scope

IN5. The Standard now excludes foreign currency derivatives that are within the scope of international or national accounting standards that address the recognition and measurement of financial instruments. (Hedge accounting that was previously excluded in IPSAS 4 will remain excluded in IPSAS 4.)

Definitions

IN6. The notion of ‘reporting currency’ has been replaced with two notions:

- functional currency—currency of the primary economic environment in which the entity operates

- presentation currency—currency in which the financial statements are presented
- IN7. The definitions of: “exchange difference”, “foreign currency”, and “net investment in a foreign operation” have been modified.

Functional Currency

- IN8. When a reporting entity prepares financial statements, the Standard requires each individual entity included in the reporting entity – whether it is a stand-alone entity, an entity with foreign operations (such as a controlling entity) or a foreign operation (such as a controlled entity) – to determine its functional currency and measure its financial performance and financial position in that currency.
- IN9. As a result of these changes:
- An entity (whether a stand-alone entity or a foreign operation) does not have a free choice of functional currency; and
 - An entity cannot avoid restatement in accordance with IPSAS 10, “Financial Reporting in Hyperinflationary Economies” by, for example, adopting a stable currency (such as the functional currency of its controlling entity) as its functional currency.
- IN10. The Standard requires an entity to disclose:
- Its functional currency when the functional currency is different from its presentation currency and to clarify why a different presentation currency has been adopted.
 - When there has been a change in functional currency, and the reasons for the change.
- IN11. The Standard replaces the previous requirement to account for a change in the classification of a foreign operation with a requirement that a change in functional currency is accounted for prospectively.

Integral Foreign Operations vs. Foreign Entities

- IN12. The Standard eliminates the distinction between integral foreign operations and foreign entities. Consequently an entity that was previously classified as an integral foreign operation will have the same functional currency as the reporting entity and only one translation method is used.

Reporting Foreign Currency Transactions in the Functional Currency - Recognition of Exchange Differences

IN13. The Standard removes the previous allowed alternative treatment where an entity could capitalize exchange differences resulting from a severe devaluation or depreciation of a currency against which there is no means of hedging. This Standard requires that such exchange differences, where applicable, be reflected in the surplus or deficit.

Use of a Presentation Currency other than the Functional Currency

IN14. The Standard clarifies that an entity is permitted to present its financial statements in any currency (or currencies).

IN15. The Standard requires that goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity only be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate. Previously, an entity was also allowed to treat these types of goodwill and fair value adjustments as assets and liabilities of the reporting entity.

Disclosure

IN16. The Standard requires that when the entity discloses financial information where the presentation currency is not its functional currency and the translation method does not comply with each applicable IPSAS, the entity shall:

- clearly identify the information as supplementary information to distinguish it from other information that complies with IPSASs;
- disclose the currency in which supplementary information is displayed; and
- disclose the entity's functional currency and the method of translation used to determine the supplementary information.

Transitional Provisions

IN17. The Standard allows first-time adopters of IPSASs to deem the cumulative translation differences that existed at the date they first adopt IPSASs as zero.

IN18. The Standard provides a new transitional provision for those entities which previously applied the eliminated alternative treatment for goodwill and fair value adjustments arising on the acquisition of a foreign operation. An entity, on first application of this Standard, is allowed to apply prospectively these types of goodwill and fair value adjustments in

accordance to the new requirements in this Standard. (Retrospective application is allowed.)

**INTERNATIONAL PUBLIC SECTOR ACCOUNTING
STANDARD 4—THE EFFECTS OF CHANGES IN FOREIGN
EXCHANGE RATES**

Objective

1. An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.
2. The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard:**
 - (a) **in accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of the relevant international or national accounting standards dealing with the recognition and measurement of financial instruments;**
 - (b) **in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation or by the equity method; and**
 - (c) **in translating an entity's results and financial position into a presentation currency.**
4. International or national accounting standards dealing with the recognition and measurement of financial instruments apply to many foreign currency derivatives and, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of these international or national accounting standards (e.g. some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.
5. This Standard does not apply to hedge accounting for foreign currency items including the hedging of a net investment in a foreign operation. Accordingly,

entities may apply the relevant international or national accounting standards dealing with hedge accounting.

6. **This Standard applies to all public sector entities other than Government Business Enterprises.**
7. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements”.
8. This Standard applies to the presentation of an entity’s financial statements in a foreign currency and sets out requirements for the resulting financial statements to be described as complying with International Public Sector Accounting Standards. For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.
9. This Standard applies to 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 apply to the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (see International Public Sector Accounting Standard IPSAS 2, “Cash Flow Statements”).

Definitions

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

Closing rate is the spot exchange rate at the reporting date.

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

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

Exchange rate is the ratio of exchange for two currencies.

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.

Foreign currency is a currency other than the functional currency of the entity.

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

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

Monetary items are units of currency held and assets and liabilities to be received or paid in fixed or determinable number of units of currency.

Net investment in a foreign operation is the amount of the reporting entity's interest in the net assets/equity of that operation.

Presentation currency is the currency in which the financial statements are presented.

Spot exchange rate is the exchange rate for immediate delivery.

Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meaning as in those other Standards, and are reproduced in the Glossary of Defined Terms published separately.

Functional Currency

11. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors in determining its functional currency:
 - (a) the currency:
 - (i) that revenue is raised from, such as taxes, grants, and fines;
 - (ii) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and
 - (iii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.
 - (b) the currency that mainly influences labor, material and other costs of providing goods and services (this will often be the currency in which such costs are denominated and settled).
12. The following factors may also provide evidence of an entity's functional currency:
 - (a) the currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated.
 - (b) the currency in which receipts from operating activities are usually retained.

13. The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its controlled entity, branch, associate or joint venture):
- (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when a department of defense has a number of overseas bases which conduct activities on behalf of a national government. The defense bases might conduct their activities substantially in the functional currency of the reporting entity. For example, military personnel may be paid in the functional 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 contrast, a foreign operation with a significant degree of autonomy may accumulate cash and other monetary items, incurs expenses, generates revenue and perhaps arranges borrowings, all substantially in its local currency. Some examples of government-owned foreign operations 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.
 - (b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.
 - (c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
 - (d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.
14. When the above indicators are mixed and the functional currency is not obvious, management uses its judgment to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 11 before considering the indicators in paragraphs 12 and 13, which are designed to provide additional supporting evidence to determine an entity's functional currency.

15. An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.
16. If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated in accordance with IPSAS 10, "Financial Reporting in Hyperinflationary Economies". An entity cannot avoid restatement in accordance with IPSAS 10 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its controlling entity).

Monetary Items

17. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: social policy obligations and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends that are recognized as a liability. Conversely, the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (e.g. prepaid rent); goodwill; intangible assets; inventories; property, plant and equipment; and provisions that are to be settled by the delivery of a non-monetary asset.

Net Investment in a Foreign Operation

18. An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 36 and 37. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Summary of the Approach Required by this Standard

19. In preparing financial statements, each entity—whether a stand-alone entity, an entity with foreign operations (such as a controlling entity) or a foreign operation (such as a controlled entity or branch)—determines its functional currency in accordance with paragraphs 11-16. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 22–41 and 58.
20. Many reporting entities comprise a number of individual entities (e.g. an economic entity is made up of a controlling entity and one or more controlled entities). Various types of entities, whether members of an economic entity or otherwise, may have investments in associates or joint ventures. They may

also have branches. It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The results and financial position of any individual entity within the reporting entity whose functional currency differs from the presentation currency are translated in accordance with paragraphs 42-58.

21. This Standard also permits a stand-alone entity preparing financial statements or an entity preparing separate financial statements in accordance with IPSAS 6, “Consolidated and Separate Financial Statements” to present its financial statements in any currency (or currencies). If the entity’s presentation currency differs from its functional currency, its results and financial position are also translated into the presentation currency in accordance with paragraphs 42-58.

Reporting Foreign Currency Transactions in the Functional Currency

Initial Recognition

22. A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:
 - (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; or
 - (c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
23. **A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.**
24. The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with International Public Sector Accounting Standards. 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 inappropriate.
25. 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

26. At each reporting date:

- (a) **foreign currency monetary items shall be translated using the closing rate;**
- (b) **non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and**
- (c) **non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined.**

27. The carrying amount of an item is determined in conjunction with other relevant International Public Sector Accounting Standards. For example, property, plant and equipment may be measured in terms of fair value or historical cost in accordance with IPSAS 17, "Property, Plant and Equipment". Whether the carrying amount is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this Standard.

28. The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories held for sale is the lower of cost and net realizable value in accordance with IPSAS 12, "Inventories". Similarly, in accordance with IPSAS 21, "Impairment of Non-Cash-Generating Assets", the carrying amount of a non-cash generating asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable service amount. When such an asset is non-monetary and is measured in a foreign currency, the carrying amount is determined by comparing:

- (a) the cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (ie the rate at the date of the transaction for an item measured in terms of historical cost); and
- (b) the recoverable service amount, as appropriate, translated at the exchange rate at the date when that value was determined (e.g. the closing rate at the reporting date).

The effect of this comparison may be that an impairment loss is recognized in the functional currency but would not be recognized in the foreign currency, or vice versa.

29. When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

Recognition of Exchange Differences

30. As noted in paragraph 5, this Standard does not deal with hedge accounting for foreign currency items. Guidance in relation to other aspects of hedge accounting, including the criteria to use hedge accounting, can be found in the relevant international or national accounting standards dealing with the measurement and recognition of financial instruments.
31. **Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognized in surplus or deficit in the period in which they arise, except as described in paragraph 36.**
32. When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. 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 period up to the date of settlement is determined by the change in exchange rates during each period.
33. The treatment of foreign currency exchange rate changes in a cash flow statement is described in paragraph 25.
34. **When a gain or loss on a non-monetary item is recognized directly in net assets/equity, any exchange component of that gain or loss shall be recognized directly in net assets/equity. Conversely, when a gain or loss on a non-monetary item is recognized in surplus or deficit, any exchange component of that gain or loss shall be recognized in surplus or deficit.**
35. Other Standards require some gains and losses to be recognized directly in net assets/equity. For example, IPSAS 17 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognized directly in net assets/equity. When such an asset is measured in a foreign currency, paragraph 26(c) of this Standard requires the revalued amount to be translated using the rate at the date the value is determined, resulting in an exchange difference that is also recognized in net assets/equity.

36. **Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (see paragraph 18) shall be recognized in surplus or deficit in the separate financial statements of the reporting entity or the individual financial statements of the of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (e.g. consolidated financial statements when the foreign operation is a controlled entity), such exchange differences shall be recognized initially in a separate component of net assets/equity and recognized in surplus or deficit on disposal of the net investment in accordance with paragraph 56.**
37. 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 31. Similarly, if 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 31. Such exchange differences are reclassified to the separate component of net assets/equity in the financial statements that include the foreign operation and the reporting entity (i.e. financial statements in which the foreign operation is consolidated, proportionally 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 net assets/equity in the financial statements that include the foreign operation and the reporting entity (i.e. they remain recognized in surplus or deficit).
38. When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial statements all amounts are translated into the functional currency in accordance with paragraphs 22-29. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate, and non-monetary items that are measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition.

Change in Functional Currency

39. **When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.**

40. As noted in paragraph 15, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices or the provision of goods and services may lead to a change in an entity's functional currency.
41. The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously classified in net assets/equity in accordance with paragraphs 36 and 43(c) are not recognized in surplus or deficit until the disposal of the operation.

Use of a Presentation Currency other than the Functional Currency

Translation to the Presentation Currency

42. An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its results and financial position into the presentation currency. For example, when an economic entity contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.
43. **The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**
- (a) **assets and liabilities for each statement of financial position presented (i.e. including comparatives) shall be translated at the closing rate at the date of that statement of financial position;**
 - (b) **revenue and expenses for each statement of financial performance (i.e. including comparatives) shall be translated at exchange rates at the dates of the transactions; and**
 - (c) **all resulting exchange differences shall be recognized as a separate component of net assets/equity.**
44. In translating the cash flows, that is the cash receipts and cash payments, of a foreign operation for incorporation in its cash flow statement, the reporting entity shall comply with the procedures in IPSAS 2. IPSAS 2 requires that the cash flows of a controlled entity which satisfies the definition of a foreign

operation shall 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.

45. For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate revenue and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
46. The exchange differences referred to in paragraph 43(c) result from:
 - (a) translating revenue and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences arise both on revenue and expense items recognized in surplus or deficit and on those recognized directly in net assets/equity.
 - (b) translating the opening net assets/equity at a closing rate that differs from the previous closing rate.

These exchange differences are not recognized in surplus or deficit because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. When the exchange differences relate to a foreign operation that is consolidated but is not wholly-owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and recognized as part of, minority interest in the consolidated statement of financial position.

47. **The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**
 - (a) **all amounts (i.e. assets, liabilities, net assets/equity items, revenue and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent statement of financial position, except that**
 - (b) **when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (i.e. not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).**
48. **When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with IPSAS 10, "Financial Reporting in Hyperinflationary Economies" before applying the translation method**

set out in paragraph 47, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy (see paragraph 47(b)). When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements in accordance with IPSAS 10, it shall use as the historical costs for translation into the presentation currency the amounts restated to the price level at the date the entity ceased restating its financial statements.

Translation of a Foreign Operation

49. Paragraphs 50-55, in addition to paragraphs 42-48, apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation, proportional consolidation or the equity method.
50. The incorporation of the results and financial position of a foreign operation with 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, “Interests in Joint Ventures”).
51. However, a monetary asset (or liability) within an economic entity, whether short-term or long-term, cannot be eliminated against the corresponding liability (or asset) within an economic entity without showing the results of currency fluctuations in the consolidated financial statements. This is 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 the reporting entity, such an exchange difference continues to be recognized in surplus or deficit or, if it arises from the circumstances described in paragraph 36, it is classified as net assets/equity until the disposal of the foreign operation.
52. When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity’s financial statements. When this is not done, IPSAS 6 allows the use of a different reporting date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates.
53. When there is a difference between the reporting date of the reporting entity and the foreign operation, the assets and liabilities of the foreign operation are translated at the exchange rate at the reporting date of the foreign operation.
54. Adjustments are made for significant changes in exchange rates up to the reporting date of the reporting entity in accordance with IPSAS 6. The same

approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation in joint ventures in accordance with IPSAS 7, “Investments in Associates” and IPSAS 8.

55. **Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 43 and 47.**

Disposal of a Foreign Operation

56. **On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of net assets/equity relating to that foreign operation shall be recognized in surplus or deficit when the gain or loss on disposal is recognized.**
57. An entity may dispose of its interest in a foreign operation through sale, liquidation, repayment of contributed capital or abandonment of all, or part of, that entity. The payment of a dividend is part of a disposal only when it constitutes a return of the investment, for example when the dividend or similar distribution is paid out of pre-acquisition surplus. In the case of a partial disposal, only the proportionate share of the related accumulated exchange difference is included in the gain or loss. A write-down of the carrying amount of a foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognized in surplus or deficit at the time of a write-down.

Tax Effects of Exchange Differences

58. 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 translating the results and financial position of an entity (including a foreign operation) into a different currency can be found in the relevant international or national accounting standards dealing with income taxes.

Disclosure

59. **In paragraphs 61 and 63-65 references to ‘functional currency’ apply, in the case of an economic entity, to the functional currency of the controlling entity.**
60. **The entity shall disclose:**
- (a) **the amount of exchange differences recognized in surplus or deficit except for those arising on financial instruments measured at fair value through surplus or deficit in accordance with the relevant**

international or national accounting standards dealing with the recognition and measurement of financial instruments; and

- (b) **net exchange differences classified in 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.**

- 61. **When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.**
- 62. **When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.**
- 63. **When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with International Public Sector Accounting Standards only if they comply with all the requirements of each applicable Standard including the translation method set out in paragraphs 43 and 47.**
- 64. An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 63. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with International Public Sector Accounting Standards and the disclosures set out in paragraph 65 are required.
- 65. **When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 63 are not met, it shall:**
 - (a) **clearly identify the information as supplementary information to distinguish it from the information that complies with International Public Sector Accounting Standards;**
 - (b) **disclose the currency in which the supplementary information is displayed; and**
 - (c) **disclose the entity's functional currency and the method of translation used to determine the supplementary information.**

Transitional Provisions

Initial Adoption of Accrual Accounting

66. **A reporting entity need not comply with the requirements for cumulative translation differences that existed at the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards. If a first-time adopter uses this exemption:**
- (a) **the cumulative translation differences for all foreign operations are deemed to be zero at the date of first adoption to International Public Sector Accounting Standards; and**
 - (b) **the gain and loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of first adoption to International Public Sector Accounting Standards, and shall include later translation differences.**
67. This Standard requires entities to:
- (a) classify some translation differences as a separate component of net assets/equity; and
 - (b) on disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation to the statement of financial performance as part of the gain or loss on disposal.

The transitional provisions provide first-time adopters of IPSASs with relief from this requirement.

Transitional Provisions for All Entities

68. **An entity shall apply paragraph 55 prospectively to all acquisitions occurring after the beginning of the financial reporting period in which this International Public Sector Accounting Standard is first applied. Retrospective application of paragraph 55 to earlier acquisitions is permitted. For an acquisition of a foreign operation treated prospectively but which occurred before the date on which this Standard is first applied, the entity shall not restate prior years and accordingly may, when appropriate, treat goodwill and fair value adjustments arising on that acquisition as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are non-monetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.**
69. **All other changes resulting from the application of this International Public Sector Accounting Standard shall be accounted for in accordance**

with the requirements of IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors”.

Effective Date

70. **An entity shall apply this International Public Sector Accounting Standard for annual periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
71. 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.

Withdrawal of IPSAS 4 (issued 2000)

72. This Standard supersedes IPSAS 4, “The Effects of Changes in Foreign Exchange Rates” issued in 2000.

Appendix

Amendments to Other Pronouncements

The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after January 1, 2008. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

A1. In IPSAS 2, “Cash Flow Statements”, paragraphs 36 and 37 are amended to read as follows:

36. **Cash flows arising from transactions in a foreign currency shall be recorded in an entity’s functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.**

37. **The cash flows of a foreign controlled entity shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.**

A2. IPSAS 10, “Financial Reporting in Hyperinflationary Economies” is amended as described below:

Paragraph 1 is amended to read as follows:

1. **An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to the individual financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.**

Paragraph 11 is amended to read as follows:

11. **The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy shall be stated in terms of the measuring unit current at the reporting date. The corresponding figures for the previous period required by International Public Sector Accounting Standard IPSAS 1, “Presentation of Financial Statements”, and any information in respect of earlier periods, shall also be stated in terms of the measuring unit current at the reporting date. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 47(b) and 48 of International Public Sector Accounting Standard IPSAS 4, “The Effects of Changes in Foreign Exchange Rates” apply.**

Paragraph 20 is amended to read as follows:

20. A general price index may not be available for the periods for which the restatement of property, plant and equipment is required by this Standard. In these circumstances, it may be necessary to use an estimate based, for example, on the movements in the exchange rate between the functional currency and a relatively stable foreign currency.

Paragraph 26 is deleted.

Paragraph 33 is amended to read as follows:

33. Corresponding figures for the previous reporting period, whether they were based on a historical cost approach or a current cost approach, are restated by applying a general price index so that the comparative financial statements are presented in terms of the measuring unit current at the end of the reporting period. Information that is disclosed in respect of earlier periods is also expressed in terms of the measuring unit current at the end of the reporting period. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 47(b) and 48 of IPSAS 4, “The Effects of Changes in Foreign Exchange Rates” apply.

Paragraph 38 is amended to read as follows:

38. **The following disclosures shall be made:**
 - (a) **the fact that the financial statements and the corresponding figures for previous periods have been restated for the changes in the general purchasing power of the functional currency and, as a result, are stated in terms of the measuring unit current at the reporting date; and...**

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 4, “The Effects of Changes in Foreign Exchange Rates”. This Basis for Conclusions only notes the IPSASB’s reasons for departing from provisions of the related International Accounting Standard.

Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)’s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB’s work program. The IPSASB’s policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the ‘comparison with IFRS’ included in each IPSAS. The Comparison with IAS 21 references the December 2003 version of IAS 21 and not any other.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)¹ as part of its General Improvements Project. The objectives of the IASB’s General Improvements project were “to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements.” The final IASs were issued in December 2003.
- BC4. IPSAS 4, issued in January 2000 was based on IAS 21 (Revised 1993), “The Effects of Changes in Foreign Exchange Rates” which was reissued in December 2003. In late 2003, the IPSASB’s predecessor, the Public Sector Committee (PSC)², actioned an IPSAS Improvements Project to converge

¹ The International Accounting Standards (IASs) were issued by the IASB’s predecessor – the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

² The PSC became the IPSASB when the IFAC Board changed the PSC’s mandate to become an independent standard-setting board in November 2004.

where appropriate IPSASs with the improved IASs issued in December 2003.

- BC5. The IPSASB reviewed the improved IAS 21 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The IASB's Bases for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website - www.iasb.org).
- BC6. IAS 21 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 4 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

Table of Concordance

This table shows how the contents of the superseded version of IPSAS 4 and the current version of IPSAS 4 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

Superseded IPSAS 4 paragraphs	Current IPSAS 4 paragraph	Superseded IPSAS 4 paragraphs	Current IPSAS 4 paragraph	Superseded IPSAS 4 paragraphs	Current IPSAS 4 paragraph
Objective	1, 2	29	None	58	None
1	3	30	None	59	None
2	4, 5	31	None	60	58
3	None	32	None	61	60
4	6	33	None	62	61, 62
5	7	34	13	63	None
6	8	35	13	64	None
7	None	36	13	65	None
8	9	37	None	66	68, 69
9	10	38	None	67	70
10	None	39	None	68	71
11	None	40	None	None	11-12
12	None	41	43	None	14-16
13	None	42	None	None	17
14	None	43	44	None	19-21
15	None	44	45	None	28, 29
16	22	45	46	None	34, 35
17	23	46	55	None	37-41
18	24	47	50	None	42
19	25	48	51	None	47
20	26	49	52	None	49
21	27	50	53	None	59
22	None	51	54	None	63-65
23	30	52	48	None	66-67
24	31	53	None	None	72
25	32	54	None		
26	33	55	56		
27	36	56	57		
28	18	57	None		

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” (2003). 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 “revenue”, “statement of financial performance”, “statement of financial position” and “net assets/equity” in IPSAS 4. The equivalent terms in IAS 21 are “income”, “income statement”, “balance sheet” and “equity”.
- IPSAS 4 contains a different set of definitions of technical terms from IAS 21 (paragraph 10).
- IPSAS 4 contains an additional transitional provision allowing an entity, when first adopting IPSASs to deem cumulative translation differences existing at the date of first adoption of accrual IPSASs as zero (paragraph 66). This transitional provision is adapted from IFRS 1, “First-time Adoption of International Financial Reporting Standards”.



International Federation of Accountants

545 Fifth Avenue, 14th Floor, New York, NY 10017 USA

Tel +1 (212) 286-9344 Fax +1 (212) 286-9570 www.ifac.org