

Foreign currency transactions

Advance consideration

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Chris Spall
Partner
KPMG International Cooperative

Draft IFRIC aims to clarify the transaction date used to determine the spot exchange rate

Highlights

- Proposals would apply in specific circumstances involving an advance foreign currency payment or receipt
- Establishing the transaction date – Needed to determine the spot exchange rate for translation
- Potential impacts – Companies should consider effects on financial reporting and accounting systems
- Transition

For foreign currency transactions involving an advance payment or receipt, current IFRS is unclear as to which date should be used for translation.

Under current IFRS, foreign currency transactions are recorded in the company's functional currency by applying the spot exchange rate on the date of the transaction – i.e. on the date when the transaction first qualifies for recognition.

However, when foreign currency consideration is paid or received in advance of the item it relates to – which may be an asset, an expense or income – IAS 21 *The Effects of Changes in Foreign Exchange Rates* is not clear on how to determine the date of the transaction. This has resulted in diversity in practice when translating the related item. To address this, the IFRS Interpretations Committee has issued a draft interpretation.

“Companies – particularly those in the construction sector – should consider the impact of these proposals on their financial reporting, as well as their accounting systems.”

When would the interpretation apply?

The interpretation would apply when a company:

- pays or receives consideration denominated or priced in a foreign currency; and
- recognises a non-monetary prepayment asset or deferred income liability – e.g. non-refundable advance consideration – before recognising the related item at a later date.

The interpretation would not apply when the related item is required to be recognised using a fair value measurement basis – e.g. financial assets and liabilities. Companies would not have to apply the interpretation to insurance contracts and income taxes.

Establishing the date of the transaction

The date of the transaction – which is required to determine the spot exchange rate for translation – would be the earlier of:

- the date of initial recognition of the non-monetary prepayment asset or deferred income liability; and
- the date that the related item is recognised in the financial statements.

Our [worked example](#) shows how the proposals would be applied.

If the transaction is recognised in stages, then a transaction date would be established for each stage. The spot exchange rate for each date would be applied to translate each part of the transaction.

Potential impacts

A company should consider:

- the potential effect of the proposals on net profit or loss;
- the proposals' interaction with other standards; and
- any changes to accounting systems that could be required to book transactions in the way the interpretation requires.

The effect of the proposals on net profit or loss may be significant if applying the proposals means the company translates an acquired asset using the spot exchange rate at the date when consideration to acquire the asset is paid, instead of at a later date – e.g. on receiving delivery of the asset.

Although exchange rates will fluctuate between these dates, no foreign exchange gains or losses would be recognised in respect of the translation of the acquired asset if the proposals are applied.

In some cases – e.g. revenue or expense transactions in foreign currency – the aggregate effect on net profit or loss may be the same regardless of which spot exchange rate is used to measure revenue or expense, but individual line items in the statement of profit or loss may be affected.

The draft interpretation does not impact the accounting for monetary assets or liabilities denominated in foreign currency – including cash held as a result of receipt of advance consideration.

It is worth bearing in mind that other standards may require initial measurement of the related item on a fair value measurement basis at a date that differs from the date when the non-monetary prepayment asset or deferred income liability is initially recognised. In this case, the draft interpretation would not apply.

Companies would be permitted to early adopt the interpretation. They would also have a choice of applying it either:

- retrospectively; or
- prospectively – i.e. from the beginning of:
 - the reporting period in which the interpretation is first applied; or
 - an earlier reporting period presented in the comparatives.

Next steps

Read our [comment letter](#).

Worked example

Foreign currency transactions – Advance consideration How the proposed amendments in the draft IFRIC would be applied

October 2015

Company C's functional currency is the euro (EUR). C receives a non-refundable amount of 100 US dollars (USD) on 1 August as advance payment for delivery of goods on 1 November. The spot EUR/USD exchange rate is 0.9 on 1 August and 1.0 on 1 November.

C would recognise cash received of USD 100 and a deferred income liability of USD 100. Both would be translated into EUR using the spot exchange rate at 1 August of 0.9 – i.e. EUR 90.

On 1 November, the deferred income liability of USD 100 would be derecognised, and revenue of USD 100 would be recognised and translated as EUR 90 using the same 1 August spot exchange rate – i.e. 0.9.

EUR/USD
spot rate

1 August
0.9

1 November
1.0

Timeline

Action

Accounting
treatment

Calculation



C receives advance consideration of **USD 100**



C delivers goods



C recognises cash received of **EUR 90**, and a deferred income liability of **EUR 90**



C derecognises the deferred income liability of **EUR 90**, and recognises revenue of **EUR 90**



USD 100 translated at **current** spot rate of **0.9** = **EUR 90**



USD 100 translated at **1 August** spot rate of **0.9** = **EUR 90**

