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Draft IFRIC Interpretation DI/2015/2

# Foreign Currency Transactions and Advance Consideration

Comments to be received by 19 January 2016

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**[Draft] IFRIC INTERPRETATION**

**Foreign Currency Transactions and  
Advance Consideration**

*Comments to be received by 19 January 2016*

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## CONTENTS

	<i>from page</i>
<b>INTRODUCTION</b>	<b>4</b>
<b>INVITATION TO COMMENT</b>	<b>5</b>
<b>[DRAFT] IFRIC INTERPRETATION <i>FOREIGN CURRENCY TRANSACTIONS AND ADVANCE CONSIDERATION</i></b>	<b>8</b>
<b>APPENDIX A</b>	
<b>Effective date and transition</b>	<b>11</b>
<b>ILLUSTRATIVE EXAMPLES</b>	<b>12</b>
<b>BASIS FOR CONCLUSIONS</b>	<b>17</b>

## Introduction

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This draft IFRIC Interpretation *Foreign Currency Transactions and Advance Consideration* (‘the draft Interpretation’) has been published by the International Accounting Standards Board’s IFRS Interpretations Committee (‘the Interpretations Committee’).

The Interpretations Committee received a question about which exchange rate to use when reporting transactions that are denominated in a foreign currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*. The request described a circumstance in which a customer paid for goods or services by making a non-refundable payment in advance.

IAS 21 sets out requirements about which exchange rate to use when recording a foreign currency transaction on initial recognition in an entity’s functional currency. However, the Interpretations Committee observed some diversity in practice in circumstances in which consideration was received or paid in advance of the recognition of the related asset, expense or income.

Consequently, the Interpretations Committee developed this draft Interpretation.

## Invitation to comment

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The Interpretations Committee invites comments on the proposals in this draft Interpretation, particularly on the questions set out below. Comments are most helpful if they:

- (a) comment on the questions as stated;
- (b) indicate the specific paragraph or group of paragraphs to which they relate;
- (c) contain a clear rationale; and
- (d) include any alternative that the Interpretations Committee should consider, if applicable.

The Interpretations Committee is not requesting comments on matters that are not addressed in this draft Interpretation.

Comments should be submitted in writing so as to be received no later than **19 January 2016**.

## Questions for respondents

### Question 1—Scope

The draft Interpretation addresses how to determine the date of the transaction for the purpose of determining the spot exchange rate used to translate foreign currency transactions on initial recognition in accordance with paragraphs 21–22 of IAS 21. Foreign currency transactions that are within the scope of the draft Interpretation are described in paragraphs 4–6 of the draft Interpretation.

Do you agree with the scope proposed in the draft Interpretation? If not, what do you propose and why?

### Question 2—Consensus

The consensus in the draft Interpretation provides guidance on how to determine the date of the transaction for the purpose of determining the spot exchange rate used to translate the asset, expense or income (or part of it) on initial recognition that relates to, and is recognised on the derecognition of, a non-monetary prepayment asset or a non-monetary deferred income liability (see paragraphs 8–11). The basis for the consensus is explained in paragraphs BC22–BC33. This includes the Interpretations Committee's consideration of the interaction of the draft Interpretation and the presentation in profit or loss of exchange differences arising on monetary items in accordance with paragraphs 28–29 of IAS 21 (see paragraphs BC32–BC33).

Do you agree with the consensus proposed in the draft Interpretation? If not, why and what alternative do you propose?

**Question 3—Transition**

On initial application, entities would apply the proposed Interpretation either:

- (a) retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; or
- (b) prospectively to all foreign currency assets, expenses and income in the scope of the proposed Interpretation initially recognised on or after:
  - (i) the beginning of the reporting period in which an entity first applies the proposed Interpretation; or
  - (ii) the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which an entity first applies the proposed Interpretation.

Do you agree with the proposed transition requirements? If not, what do you propose and why?

**How to comment**

Comments should be submitted using one of the following methods.

**Electronically** Visit the ‘Comment on a proposal’ page, which can be found at:  
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FOREIGN CURRENCY TRANSACTIONS AND ADVANCE CONSIDERATION

[Draft] IFRIC Interpretation X *Foreign Currency Transactions and Advance Consideration* (IFRIC X) is set out in paragraphs 1–11 and Appendix A. [Draft] IFRIC X is accompanied by Illustrative Examples and a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 2 and 7–14 of the *Preface of International Financial Reporting Standards*.



## **[Draft] IFRIC Interpretation X**

### ***Foreign Currency Transactions and Advance Consideration***

#### **References**

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- *The Conceptual Framework for Financial Reporting*
- IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
- IAS 21 *The Effects of Changes in Foreign Exchange Rates*

#### **Background**

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- 1 Paragraphs 21–22 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* require that a foreign currency transaction must be recorded, on initial recognition in the entity's functional currency, by applying the spot exchange rate to the foreign currency amount at the date of the transaction. The date of the transaction is the date on which the transaction first qualifies for recognition in accordance with International Financial Reporting Standards (IFRS).
- 2 In circumstances in which an entity pays or receives some or all of the foreign currency consideration in advance of the recognition of the related asset, expense or income, the entity generally recognises a non-monetary asset or liability.<sup>1</sup> This non-monetary asset represents an entity's right to receive goods or services (a 'prepayment asset') and the non-monetary liability represents an entity's obligation to transfer goods or services (a 'deferred income liability').<sup>2</sup> The prepayment asset or deferred income liability is subsequently derecognised when the related asset, expense or income is recognised in accordance with the relevant Standards.
- 3 The IFRS Interpretations Committee received a question about how to determine the date of the transaction in accordance with paragraphs 21–22 of IAS 21, and thus the exchange rate to use to translate the asset, expense or income on initial recognition, in circumstances in which a non-monetary prepayment asset or a non-monetary deferred income liability is recognised in advance of the related asset, income or expense.

#### **Scope**

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- 4 This [draft] Interpretation applies to a foreign currency transaction (or part of it) in circumstances in which:
  - (a) there is consideration that is denominated or priced in a foreign currency;

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1 In addition, paragraph 105 of IFRS 15 *Revenue from Contracts with Customers* requires that if a customer pays consideration, or an entity has a right to an amount of consideration that is unconditional, before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier).

2 IFRS 15 uses the terminology 'contract liability' instead of 'deferred income liability'.

- (b) the entity recognises a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income (or part of it); and
  - (c) the prepayment asset or deferred income liability is non-monetary.
- 5 The [draft] Interpretation does not apply in circumstances in which the related asset, expense or income is required to be recognised initially at:
- (a) its fair value; or
  - (b) the fair value of the consideration given or received if that consideration is measured in the foreign currency at a date other than the date of initial recognition of the related prepayment asset or deferred income liability.
- 6 An entity is not required to apply this [draft] Interpretation to:
- (a) insurance contracts (including reinsurance contracts) that it issues and reinsurance contracts that it holds; and
  - (b) income taxes.

## Issue

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- 7 This [draft] Interpretation addresses how to determine the date of the transaction for the purpose of determining the spot exchange rate used to translate the asset, expense or income (or part of it) on initial recognition that relates to, and is recognised on the derecognition of, a non-monetary prepayment asset or a non-monetary deferred income liability.

## Consensus

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- 8 The date of the transaction, for the purpose of determining the spot exchange rate used to translate the related asset, expense or income (or part of it) on initial recognition in accordance with paragraphs 21–22 of IAS 21, is the earlier of:
- (a) the date of initial recognition of the non-monetary prepayment asset or the non-monetary deferred income liability; and
  - (b) the date that the asset, expense or income (or part of it) is recognised in the financial statements.
- 9 If the transaction is recognised initially in stages (including any non-monetary prepayment assets or non-monetary deferred income liabilities), then a date of transaction is established for each stage. This may be the case, for example, if there:
- (a) are multiple payments or receipts in advance;
  - (b) are multiple goods to be delivered at different times and/or services rendered over time; or
  - (c) is a combination of multiple goods and/or services with some advance payments or receipts and some payments or receipts in arrears.

- 10 When there is more than one date of the transaction, the spot exchange rate for each date shall be applied to translate that part of the transaction. When that date is the date of the initial recognition of a non-monetary prepayment asset or a non-monetary deferred income liability, the same exchange rate is used on initial recognition of the related part of the asset, expense or income.
- 11 The related asset, expense or income (or part of it) is that part that is recognised on the derecognition of the non-monetary prepayment asset or the non-monetary deferred income liability, as determined by IFRS.

## Appendix A Effective date and transition

*This appendix is an integral part of [draft] IFRIC X and has the same authority as the other parts of [draft] IFRIC X.*

### Effective date

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- A1 An entity shall apply this [draft] Interpretation for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies this [draft] Interpretation for an earlier period, it shall disclose that fact.

### Transition

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- A2 On initial application, an entity shall apply this [draft] Interpretation either:
- (a) retrospectively to each prior reporting period presented in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*; or
  - (b) prospectively to all assets, expenses and income in the scope of the [draft] Interpretation initially recognised on or after:
    - (i) the beginning of the reporting period in which an entity first applies the [draft] Interpretation; or
    - (ii) the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which an entity first applies the [draft] Interpretation.
- A3 If an entity applies paragraph A2(b) on initial application, the entity:
- (a) shall not adjust previously reported amounts recognised in respect of non-monetary prepayment assets and non-monetary deferred income liabilities prior to the respective reporting period in paragraph A2(b)(i) or (ii); but
  - (b) shall apply the [draft] Interpretation to assets, expenses and income initially recognised on or after the beginning of the respective reporting period in paragraph A2(b)(i) or (ii) for which non-monetary prepayment assets or non-monetary deferred income liabilities have been recognised before that date.

## **[Draft] IFRIC X Foreign Currency Transactions and Advance Consideration**

### **Illustrative Examples**

*These examples accompany, but are not part of, [draft] IFRIC X.*

- IE1 The objective of these examples is to illustrate how an entity may determine the date of the transaction and thus the spot exchange rate in circumstances in which an entity enters into a foreign currency transaction and receives or pays advance consideration.

#### **Example 1—A single advance payment for the purchase of a single item of property, plant and equipment**

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- IE2 Entity A enters into a non-cancellable contract with a supplier on 1 March 20X1 to purchase a machine for use in its business. Under the terms of the contract, Entity A pays the supplier a non-refundable fixed purchase price of FC1,000 on 1 April 20X1.<sup>3, 4</sup> On 15 April 20X1, Entity A takes delivery of the machine. The transaction does not result in an onerous contract.
- IE3 The transaction is first recorded in the financial statements by Entity A on 1 April 20X1 on payment of FC1,000, which establishes the date of the transaction for determining the spot exchange rate at which to translate the transaction into Entity A's functional currency. At this date Entity A recognises a non-monetary prepayment asset translated using the spot exchange rate at that date. The prepayment asset is a non-monetary item, because it represents the right to receive a machine, so it is not subsequently retranslated in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*.
- IE4 On 15 April 20X1, Entity A takes delivery of the machine. It derecognises the prepayment asset and recognises the machine as property, plant and equipment in accordance with IAS 16 *Property, Plant and Equipment*. On initial recognition of the machine, Entity A records the cost of the machine by translating the machine's FC1,000 purchase price using the spot exchange rate at the date of the transaction, which is 1 April 20X1 (the date of the initial recognition of the prepayment asset).

#### **Example 2—Multiple receipts for revenue recognised at a single point in time**

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- IE5 Entity B enters into a non-cancellable contract with a customer on 1 June 20X2 to deliver goods on 1 September 20X2. The total fixed contract price is an amount of FC100, of which FC40 is a non-refundable amount received on 1 August 20X2 and the balance is receivable on 30 September 20X2. On delivery of the goods, the right to the remaining consideration is unconditional.

<sup>3</sup> In these Illustrative Examples, foreign currency amounts are denominated in 'foreign currency units' (FC) and functional currency amounts are denominated in 'currency units' (CU).

<sup>4</sup> For illustrative purposes, these examples assume that the consideration is non-refundable; however, the [draft] Interpretation applies to all transactions that are within the scope as set out in paragraphs 4–6.

Applying IFRS 15 *Revenue from Contracts with Customers*, Entity B determines that because the amount of consideration in the foreign currency is fixed, the variable consideration requirements in IFRS 15 do not apply. Hence, it concludes that revenue is recognised at the date that control of the goods is transferred to the customer and the amount of the transaction price is not subsequently re-estimated.

- IE6 In accordance with IFRS 15, Entity B recognises a contract liability of FC40 on 1 August 20X2. This is translated into Entity B's functional currency using the spot exchange rate at that date. The contract liability is a non-monetary item, so in accordance with IAS 21 it is not subsequently retranslated.
- IE7 Control of the goods is transferred to the customer on 1 September 20X2 and Entity B recognises revenue of FC100.
- IE8 This transaction first qualified for recognition in the financial statements in two stages:
- (a) FC40 on 1 August 20X2 on receipt of the advance payment, leading to the recognition of the contract liability; and
  - (b) FC60 on 1 September 20X2 on transfer of control of the goods to the customer, leading to the recognition of the revenue and a corresponding receivable.
- IE9 Consequently, a date of the transaction is established for each of the stages for the purpose of determining the spot exchange rate used to translate the revenue. FC40 of the revenue is translated using the spot exchange rate on 1 August 20X2 and FC60 of the revenue is translated using the spot exchange rate on 1 September 20X2.
- IE10 The receivable of FC60 recognised on 1 September 20X2 is a monetary item, so it is subsequently retranslated into Entity B's functional currency until the receivable is settled on 30 September 20X2, in accordance with IAS 21.

### **Example 3—Multiple payments for purchases of services recognised over a period of time**

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- IE11 On 1 May 20X3, Entity C enters into a contract with a supplier for services. The services will be received continuously for six months from 1 July 20X3. The contract requires Entity C to pay the supplier a non-refundable amount of FC200 on 15 June 20X3 for the services to be received in the period of July–August 20X3 and FC400 on 31 December 20X3 for the services to be received in the period September–December 20X3.
- IE12 Entity C recognises a non-monetary prepayment asset on 15 June 20X3 for the FC200, which is translated into its functional currency using the spot exchange rate on 15 June 20X3. Entity C derecognises the prepayment asset and recognises an expense in the income statement over the period in which it receives the related services, which it determines to be from 1 July–31 August

20X3.<sup>5</sup> For the purpose of translating the FC200 expense for this period, the date of the transaction is 15 June 20X3 and therefore Entity C recognises the expense for the period 1 July–31 August 20X3 using the spot exchange rate at 15 June 20X3.

- IE13 Entity C does not make an advance payment for services delivered from 1 September–31 December 20X3 and, therefore, first recognises this part of the transaction when it recognises the expense in the income statement. In principle, the dates of the transaction are each day in the period 1 September–31 December 20X3. However, if exchange rates do not fluctuate significantly, Entity C may use a rate that approximates the actual rates as permitted by paragraph 22 of IAS 21. If that is the case, then Entity C may translate each month's FC100 expense ( $FC400 \div 4$ ) into its functional currency using the average spot exchange rate for each month (for example) for the period 1 September–31 December 20X3.
- IE14 As Entity C recognises the expense in the income statement over this period, it will recognise a corresponding liability in respect of its obligation to pay the supplier. Because the liability will be paid in a fixed number of units of currency, it meets the definition of a monetary item in paragraph 8 of IAS 21. Thus, it will be retranslated until the liability is settled on 31 December 20X3. The exchange differences will be recognised in profit or loss in the period in which they arise, in accordance with paragraph 28 of IAS 21.

#### **Example 4—Multiple receipts for revenue recognised at multiple points in time**

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- IE15 On 1 January 20X4, Entity D enters into a non-cancellable contract to sell two products to a customer. Control of one product is transferred on 1 March 20X4 and the second on 1 June 20X4. In accordance with the contract, the customer pays a non-refundable fixed purchase price of FC1,000, of which FC200 is received on 31 January 20X4 and the balance is received on 1 June 20X4. Entity D determines that:
- (a) on applying IFRS 15, FC450 of the transaction price is allocated to the first product and FC550 to the second product.
  - (b) the FC200 consideration received on 31 January 20X4 relates to the first product delivered on 1 March 20X4 and, on transfer of control of that product to the customer, Entity D has an unconditional right to FC250 of the remaining consideration.<sup>6</sup>
  - (c) the variable consideration requirements in IFRS 15 do not apply, because the amount of consideration in the foreign currency is fixed. Accordingly, the amount of the transaction price is not subsequently re-estimated after the recognition of revenue.

<sup>5</sup> As noted in paragraph BC31, the prepayment asset is derecognised when the rights associated with the prepayment asset are fulfilled. The basis for derecognising the prepayment asset may differ depending on the facts and circumstances.

<sup>6</sup> As noted in paragraph BC31, the contract liability (ie deferred income liability) is derecognised when the obligations associated with the contract liability are fulfilled. The basis for derecognising the contract liability may differ depending on the facts and circumstances.

FOREIGN CURRENCY TRANSACTIONS AND ADVANCE CONSIDERATION

IE16 The spot exchange rates into the entity's functional currency are:

Date	Spot exchange rate FC:CU
31 January 20X4	1:1.5
1 March 20X4	1:1.7
1 June 20X4	1:1.9

IE17 The following journal entries illustrate how the entity would account for the foreign currency aspects of the contract:

- (a) the entity receives cash of FC200 on 31 January 20X4 (cash is received in advance of the performance). This is translated into the entity's functional currency using the spot exchange rate at 31 January 20X4.

Dr Cash (FC200)	CU300
Cr Contract liability (FC200)	CU300

- (b) the contract liability is a non-monetary item and, in accordance with IAS 21, is not retranslated after initial recognition.

- (c) the entity transfers control of the first product with a transaction price of FC450 on 1 March 20X4. Entity D derecognises its contract liability representing the FC200 advance consideration that it received and recognises FC200 of the revenue translated at the spot exchange rate on the date of the transaction (31 January 20X4) for that part of the transaction price. The entity recognises the remaining FC250 of revenue and the corresponding receivable for the unconditional right to consideration, which are both translated at the spot exchange rate at the date that the remaining FC250 of the transaction price is initially recognised, ie at 1 March 20X4.

Dr Contract liability (FC200)	CU300
Dr Receivable (FC250)	CU425
Cr Revenue (FC450)	CU725

- (d) the receivable of FC250 is a monetary item. It is therefore retranslated in accordance with IAS 21 at the end of each reporting period until the date of settlement (1 June 20X4), at which date it is equivalent to CU475. The exchange gain is recognised in profit or loss for the period.

Dr Receivable	CU50
Cr Foreign exchange gain	CU50

- (e) the entity transfers control of goods with a transaction price of FC550 and receives consideration of FC800 on 1 June 20X4. It recognises the FC550 of revenue using the spot exchange rate at the date of the transaction, which is the date that this part of the transaction is first recognised in the financial statements, ie on 1 June 20X4. The FC800



cash received is translated at the spot exchange rate on 1 June 20X4. FC250 of the consideration received settles the receivable of FC250 arising on the sale of the first product.

Dr Cash (FC800)	CU1,520	
Cr Receivable (FC250)		CU475
Cr Revenue (FC550)		CU1,045

## **Basis for Conclusions on [draft] IFRIC X**

### ***Foreign Currency Transactions and Advance Consideration***

*This Basis for Conclusions accompanies, but is not part of, [draft] IFRIC X.*

#### **Introduction**

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BC1 This Basis for Conclusions summarises the considerations of the IFRS Interpretations Committee ('the Interpretations Committee') in reaching its consensus.

#### **Background**

BC2 The Interpretations Committee received a request about which exchange rate to use when reporting revenue transactions that are denominated in a foreign currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*. The submission described a circumstance in which the customer paid for the goods or services by making a non-refundable payment in advance.

BC3 The Interpretations Committee noted that paragraphs 21–22 of IAS 21 require that a foreign currency transaction must 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. The date of the transaction is the date on which the transaction first qualifies for recognition in accordance with International Financial Reporting Standards (IFRS).

BC4 The Interpretations Committee noted that its outreach indicated that:

- (a) the issue affects a number of jurisdictions, and particularly affects the construction industry;
- (b) there is diversity in practice between recognising revenue using the spot exchange rate at the date of the receipt of the non-refundable advance payment and the spot exchange rate at the date of the transfer of goods or services; and
- (c) the diversity was expected to continue when IFRS 15 *Revenue from Contracts with Customers* is applied.

BC5 In response to the noted diversity in practice, the Interpretations Committee decided to develop an Interpretation of IAS 21.

#### **Interaction with other Standards**

BC6 The Interpretations Committee noted that the principle in paragraph 24 of IAS 21 implies that the measurement requirements of other Standards are applied to the foreign currency amounts and, separately, those amounts are translated into the entity's functional currency in accordance with IAS 21. Consistently with this, other Standards do not contain any explicit guidance in respect of the foreign exchange aspects of transactions.

BC7 The Interpretations Committee noted that IAS 21 refers to other Standards. To determine the date of the transaction, paragraph 22 of IAS 21 requires an entity

to refer to the recognition requirements of other Standards. Similarly, the exchange rate to use at the end of each subsequent reporting period for a non-monetary item depends upon the measurement basis (historical cost or fair value) of the carrying amount, as required by other Standards. However, having determined the date of initial recognition and the measurement basis in accordance with other Standards, IAS 21 is applied to determine which exchange rate should be used to translate those foreign currency items into an entity's functional currency.

- BC8 The Interpretations Committee thinks that this provides a basis for interpreting IAS 21 without needing to interpret the recognition or measurement requirements of other Standards.

## Scope

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### Foreign currency transactions other than revenue from contracts with customers

- BC9 The issue was raised within the context of foreign currency revenue transactions. However, as an interpretation of IAS 21, the Interpretations Committee decided that the [draft] Interpretation should not be restricted to revenue transactions, but should also apply to the initial recognition of other foreign currency transactions that are similarly affected by the issue. This is because IAS 21 applies to all foreign currency transactions.
- BC10 The Interpretations Committee noted that similar issues arise when consideration denominated or priced in a foreign currency is paid or received in advance in respect of other transactions. For example:
- (a) purchases and sales of property, plant and equipment;
  - (b) purchases and sales of intangible assets;
  - (c) purchases and sales of investment property;
  - (d) purchases of inventory;
  - (e) purchases of services;
  - (f) entering into lease contracts; and
  - (g) on the receipt of some government grants.
- BC11 Although similar circumstances could arise in respect of insurance contracts and income taxes, the Interpretations Committee decided that the [draft] Interpretation need not apply to such transactions. This is to avoid any unintended consequences because:
- (a) the foreign exchange implications of insurance contracts are being addressed as part of the International Accounting Standards Board's project on Insurance Contracts; and
  - (b) of complexities in respect of income taxes due to the interplay with deferred tax.

**Non-cash consideration**

- BC12 Advance consideration may be denominated or priced in a foreign currency, but in a form other than cash. For example, an entity may receive equity instruments, or an item of inventory that has a fair value determined in a foreign currency, in exchange for the provision of services.
- BC13 The Interpretations Committee noted that IAS 21 applies to both cash and non-cash foreign currency transactions. In particular, the requirements for determining the date of the transaction for the purpose of determining the exchange rate to apply on initial recognition of foreign currency transactions in paragraphs 21–22 of IAS 21 do not distinguish between cash and non-cash transactions. The Interpretations Committee concluded that the [draft] Interpretation should apply to foreign currency transactions with cash and/or non-cash consideration that is denominated or priced in a foreign currency.

**Transactions measured at fair value on initial recognition**

- BC14 The principles in paragraph 23(c) of IAS 21 require that when a non-monetary item is measured at fair value and fair value is determined in a foreign currency, the foreign currency amount is translated using the spot exchange rate at that measurement date. Consequently, the Interpretations Committee observed that if, after the initial recognition of a non-monetary prepayment asset or a non-monetary deferred income liability, that amount is required to be remeasured to reflect a fair value in a foreign currency on the initial recognition of the related asset, expense or income (or part of it), this [draft] Interpretation would not be applicable.
- BC15 The Interpretations Committee observed that when an asset, expense or income is required to be measured at a fair value on initial recognition, this could be at either:
- (a) the fair value of the consideration paid or received. This occurs in circumstances in which the transaction involves non-cash consideration, for example, non-cash consideration included in revenue in accordance with IFRS 15. Other examples include property, plant and equipment purchased in exchange for non-monetary assets (unless the fair value of the asset(s) received is more clearly evident); and determining the amount of consideration in the calculation of goodwill in accordance with IFRS 3 *Business Combinations*.
  - (b) the fair value of the asset, expense or income. Examples include the initial recognition of most identifiable assets and liabilities in a business combination; financial assets and financial liabilities; and goods or services purchased from a non-employee through an equity-settled share-based payment transaction (provided that the fair value of the goods or services can be estimated reliably).
- BC16 On initial recognition of an asset, expense or income, the applicable Standard may require that the fair value of either the consideration paid or received or the asset, expense or income is measured:

- (a) at the date that the prepayment asset or deferred income liability is recognised. In this case, the foreign currency amount that resulted in the recognition of the non-monetary prepayment asset or the non-monetary deferred income liability is not subsequently remeasured to fair value on initial recognition of the related asset, expense or income.
- (b) at a measurement date other than the date of initial recognition of the related non-monetary prepayment asset or non-monetary deferred income liability. This is the case, for example, when the asset, expense or income is required to be measured at its fair value at the date of its initial recognition (instead of at the amount of the related non-monetary prepayment asset or non-monetary deferred income liability).

BC17 In the first scenario in paragraph BC16(a), the Interpretations Committee concluded that this [draft] Interpretation would be applicable. This is because after the prepayment asset and the deferred income liability are initially recognised, that underlying foreign currency amount is included unchanged in the initial measurement of the related asset, expense or income (or part of it).

BC18 However, in the second scenario described in paragraph BC16(b), the Interpretations Committee concluded that this [draft] Interpretation would not be applicable. This is because the date of measurement of the fair value used to measure the asset, expense or income on initial recognition would determine the date of the spot exchange rate to use to translate the asset, expense or income on initial recognition, in accordance with the principle in paragraph 23(c) of IAS 21.

BC19 Accordingly, the Interpretations Committee concluded that this [draft] Interpretation does not apply in circumstances in which the related asset, expense or income (or part of it) is required to be measured on initial recognition using a different measurement basis from the foreign currency amount recognised for the non-monetary prepayment asset or the non-monetary deferred income liability.

### **Monetary items**

BC20 An advance receipt or payment of consideration typically gives rise to a non-monetary prepayment asset or a non-monetary deferred income liability. However, the terms of the transaction could be such that the advance consideration gives rise to a prepayment asset or a deferred income liability that is a foreign currency-denominated monetary item instead of a non-monetary item.

BC21 When the prepayment asset or the deferred income liability is a monetary item, paragraphs 28–29 of IAS 21 require that an exchange difference is recognised in profit or loss when there is a change in the exchange rate between the transaction date and the date of settlement of that asset or liability. Consequently, the issue about which exchange rate to use on initial recognition of the asset, expense or income only arises when the advance consideration gives rise to the recognition of a non-monetary prepayment asset or a non-monetary deferred income liability. Accordingly, the Interpretations Committee decided

that this [draft] Interpretation should only deal with circumstances in which the advance consideration denominated or priced in a foreign currency gives rise to the recognition of a prepayment asset or a deferred income liability that is a non-monetary item.

## Consensus

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### The date of the transaction

- BC22 Paragraph 22 of IAS 21 defines the date of the transaction for determining which exchange rate to use on the initial recognition of a foreign currency transaction as ‘the date that the transaction first qualifies for recognition in accordance with IFRSs’.
- BC23 The Interpretations Committee observed that there could be two ways of identifying ‘the transaction’ for the purpose of determining which exchange rate to use:
- (a) the ‘one-transaction’ approach: entering into a contract, the receipt or payment of consideration and transferring the goods or services are all part of the same transaction. Thus, the date of the transaction is determined by the date on which the first element of the transaction qualifies for recognition in accordance with IFRS.
  - (b) the ‘multi-transaction’ approach: entering into a contract, the receipt or payment of consideration and transferring the goods or services are separate transactions, each of which will have its own ‘date of the transaction’ when it first qualifies for recognition in accordance with IFRS.
- BC24 The multi-transaction approach treats the transfer of goods or services and the receipt or payment of consideration as two distinct events. This approach would result in a date of transaction (and thus the date of the spot exchange rate) that was the same as the date of recognition of the asset, expense or income, regardless of the timing of the payment or receipt of consideration. On the other hand, the one-transaction approach is consistent with the notion that purchases and sales represent exchange transactions and reflects the view that the payment and transfer of goods or services are inherently interdependent. Accordingly, if the first element of the transaction to be recognised is a non-monetary prepayment asset or a non-monetary deferred income liability, that would determine the date of the transaction for the purpose of translating the subsequently recognised related asset, expense or income (or part of it).
- BC25 The Interpretations Committee concluded that the one-transaction approach is a more appropriate interpretation of IAS 21 when the advance consideration gives rise to a non-monetary prepayment asset or a non-monetary deferred income liability, because:
- (a) it reflects that an entity is no longer exposed to foreign exchange risk in respect of the transaction to the extent that it has received or paid any advance consideration. In other words, after receipt, the entity can control whether or not to continue to hold the foreign currency consideration and be exposed to foreign exchange risk; and after an

advance payment of foreign currency consideration, the entity is no longer exposed to foreign exchange risk in respect of that amount.

- (b) the obligation to perform, reflected in the recognition of a deferred income liability, and the subsequent fulfilment of that obligation (which gives rise to income) are interdependent and are part of the same transaction;
- (c) similarly, the right to future assets, goods or services, reflected in the recognition of a prepayment asset, and the subsequent fulfilment of those rights (which gives rise to the recognition of the asset or expense to which the prepayment relates), are inherently interdependent; and
- (d) it is consistent with the treatment of prepayment assets and deferred income liabilities as non-monetary items, because such items are not subsequently retranslated in accordance with IAS 21.

BC26 Furthermore, the Interpretations Committee concluded that for a transaction to 'qualify for recognition in accordance with IFRSs', the transaction must be recorded in the financial statements with a value. The Interpretations Committee observed that paragraph 4.46 of *The Conceptual Framework for Financial Reporting* notes that 'in practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements'.<sup>7</sup>

BC27 Consequently, the Interpretations Committee concluded that the earliest date on which the first element of the transaction is recognised in the financial statements with a value determines the date of the transaction, in accordance with paragraph 22 of IAS 21. If an entity recognises a non-monetary prepayment asset or a non-monetary deferred income liability, the date of initial recognition of that prepayment asset or deferred income liability is the date of the transaction. The date of initial recognition of the prepayment asset or the deferred income liability is generally the date on which the entity pays or receives the advance consideration. In addition, the Interpretations Committee observed that paragraph 106 of IFRS 15 requires that if an entity has a right to an amount of consideration in accordance with a contract with a customer that is unconditional, before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability (ie a deferred income liability) when the payment is due (if earlier than the date payment is made). However, if an entity does not recognise a prepayment asset or a deferred income liability because, for example, payment is in arrears, the date of the transaction is the date that the asset, expense or income is initially recognised.

<sup>7</sup> In May 2015 the IASB published Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting*, which if finalised would replace parts of the existing *Conceptual Framework*. Executory contracts (ie contracts that are equally unperformed) are discussed in paragraphs 4.40–4.42 of that Exposure Draft. This states that an executory contract establishes a right and an obligation to exchange economic resources and that the combined right and obligation constitute a single asset or liability. The entity has an asset if the terms of the exchange are favourable; it has a liability if the terms of the exchange are unfavourable. Whether the asset or liability is included in the financial statements depends on both the recognition criteria and the measurement basis adopted for the contract, including, if applicable, any test for whether the contract is onerous.

**Multiple payments for multiple goods or services recognised over time**

- BC28 The Interpretations Committee observed that if only part of the consideration is received or paid in advance, only part of the transaction has been recognised initially as a non-monetary prepayment asset or a non-monetary deferred income liability. Hence, the date of the transaction has been determined only for that part of the related asset, expense or income. If the remainder of the consideration is paid in arrears, the date of the transaction for the remaining part of the related asset, expense or income will be the date(s) on which that part(s) of the asset, expense or income is recognised in the financial statements. Consequently, only the part of the related asset, expense or income that is recognised on fulfilment of the non-monetary prepayment asset or settlement of the non-monetary deferred income liability will be translated on initial recognition into the entity's functional currency, using the spot exchange rate at the date of recognition of the prepayment asset or the deferred income liability. The remaining part(s) of the asset, expense or income will be translated on initial recognition using the spot exchange rate at the date that part is recognised.
- BC29 The Interpretations Committee thinks that this treatment reflects that an entity has no foreign exchange risk in respect of the foreign currency amounts already paid or received, but is still exposed to foreign exchange risk in respect of the outstanding consideration. This treatment is also consistent with using the spot exchange rate at the date of recognition of the asset, expense or income when the payment or receipt of all the consideration is in arrears and the transaction is recognised over time, as the goods or services are transferred.
- BC30 Consequently, the Interpretations Committee concluded that if the transaction is initially recognised in stages (including any non-monetary prepayment asset or non-monetary deferred income liability), a date of the transaction should be determined for each stage.
- BC31 For transactions that are recognised as assets, expenses or income at multiple points in time, or over time, it is necessary to determine which part of the asset, expense or income should be translated on initial recognition using the spot exchange rate on the date of recognition of the prepayment asset or the deferred income liability. The Interpretations Committee noted that the prepayment asset or the deferred income liability is derecognised when the related part of the asset, expense or income is recognised, reflecting when the rights or obligations associated with the prepayment asset or the deferred income liability are fulfilled. This pattern of derecognition and recognition determines the part of the related asset, income or expense that is translated using the spot exchange rate on the date of the initial recognition of the non-monetary prepayment asset or the non-monetary deferred income liability. This pattern is determined by the applicable Standards and is not affected by the denomination of the transaction in a foreign currency.



## **Interaction with the presentation of exchange differences arising on monetary items**

- BC32 The Interpretations Committee considered the interaction of the [draft] Interpretation with the presentation of exchange differences on the settlement or retranslation of monetary items that, in accordance with paragraphs 28–29 of IAS 21, are recognised in profit or loss in the period in which they arise.
- BC33 The Interpretations Committee thinks that the question of the presentation of exchange differences in profit or loss is not relevant to the issue being addressed by the [draft] Interpretation. This is because the [draft] Interpretation is only an interpretation of the meaning of the ‘date of the transaction’ for the purpose of the initial recognition of a foreign currency transaction in the functional currency in accordance with paragraphs 21–22 of IAS 21.

## **Transition**

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- BC34 The Interpretations Committee observed that full retrospective application on transition to the [draft] Interpretation, in particular for foreign currency transactions involving purchases of assets, may be burdensome. Furthermore, entities may not have sufficient information to make a reliable adjustment of comparatives. Consequently, the Interpretations Committee decided that, on initial application, entities should have the option of relief from retrospectively adjusting all assets, expenses and income (or parts of them) that were recognised before either the beginning of the current reporting period or the beginning of a prior reporting period presented as comparative information in the first reporting period of application.
- BC35 If an entity applies the [draft] Interpretation prospectively on initial application, as permitted in paragraph A2(b) of Appendix A, an adjustment to opening equity (or previously reported financial statements) is not needed. This is because the [draft] Interpretation does not affect the date of transaction, measurement or recognition basis of any non-monetary prepayment assets or non-monetary deferred income liabilities.

## **First-time adopters**

- BC36 The Interpretations Committee noted that if there are significant implications of the [draft] Interpretation for first-time adopters of IFRS, IFRS 1 *First-time adoption of International Financial Reporting Standards* already contains an election to measure an item of property, plant and equipment, investment property or intangible assets at fair value and use that fair value as its deemed cost.
- BC37 Consequently, the Interpretations Committee decided that no specific requirements or exemptions are needed for first-time adopters in respect of this [draft] Interpretation.

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