INTERPRETATION OF STATUTORY BOARD FINANCIAL REPORTING STANDARD

INT SB-FRS 7

Introduction of the Euro

Paragraph 14 of SB-FRS 1 Presentation of Financial Statements requires that financial statements should not be described as complying with Statutory Board Financial Reporting Standards unless they comply with all the requirements of each applicable Standard and each applicable Interpretation of the Statutory Boards' Financial Reporting Standard. INT SB-FRSs are not intended to apply to immaterial items.

Reference: SB-FRS 21 *The Effects of Changes in Foreign Exchange Rates*

ISSUE

1. From 1 January 1999, the effective start of Economic and Monetary Union (EMU), the euro will become a currency in its own right and the conversion rates between the euro and the participating national currencies will be irrevocably fixed, i.e. the risk of subsequent exchange differences related to these currencies is eliminated from this date on.

2. The issue is the application of SB-FRS 21 to the changeover from the national currencies of participating Member States of the European Union to the euro ("the changeover").

CONSENSUS

3. The requirements of SB-FRS 21 regarding the translation of foreign currency transactions and financial statements of foreign operations should be strictly applied to the changeover. The same rationale applies to the fixing of exchange rates when countries join EMU at later stages.

4. This means that, in particular:

   (a) foreign currency monetary assets and liabilities resulting from transactions shall continue to be translated into the functional currency at the closing rate. Any resultant exchange differences shall be recognised as income or expense immediately, except that an entity shall continue to apply its existing accounting policy for exchange gains and losses related to hedges of the currency risk of a forecast transaction.

   (b) cumulative exchange differences relating to the translation of financial statements of foreign operations shall continue to be classified as equity and shall be recognised as income or expense only on the disposal of the net investment in the foreign operation.

BASIS FOR CONCLUSIONS

5. SB-FRS 21.23~~11~~(a) requires that foreign currency monetary items (as defined by SB-FRS 21.8~~07~~) be reported using the closing rate at each balance sheet date. According to SB-FRS 21.28~~15~~, exchange differences arising from the translation of monetary items generally should be recognised as income or as expenses in the period in which they

arise. The effective start of the EMU after the balance sheet date does not change the application of these requirements at the balance sheet date; in accordance with SB-FRS 10.10~~8~~[*] it is not relevant whether or not the closing rate can fluctuate after the balance sheet date.

6. SB-FRS 21.5~~14~~ states that the Standard does not apply to ~~deal with~~ hedge accounting. ~~except in restricted circumstances.~~ Therefore, this Interpretation does not address how foreign currency hedges should be accounted for. SB-FRS 8~~.42~~ would allow such a change in accounting policy only if the change would result in a more appropriate presentation of events or transactions.[*] The effective start of EMU, of itself, does not justify a change to an entity's ~~enterprise's~~ established accounting policy related to ~~anticipatory~~ hedges of forecast transactions because the changeover does not affect the economic rationale of such hedges. Therefore, the changeover should not alter the accounting policy where gains and losses on financial instruments used as ~~anticipatory~~ hedges of forecast transactions are ~~currently deferred~~ initially recognised in equity and matched with the related income or expense in a future period.

7. SB-FRS 21.48~~37~~ requires the cumulative amount of exchange differences relating to the translation of the financial statements of a foreign operation ~~entity~~ which have been deferred in equity in accordance with SB-FRS 21.~~17, 19 or 30~~32 or 39(c) to be recognised as income or expenses in the same period in which the gain or loss on disposal of the foreign operation ~~entity~~ is recognised. The fact that the cumulative amount of exchange differences will be fixed under EMU does not justify immediate recognition as income or expenses since the wording and the rationale of SB-FRS 21.48~~37~~ clearly preclude such a treatment.

~~8. Under the Allowed Alternative Treatment of SB-FRS 21.21, exchange differences resulting from severe devaluations of currencies are included in the carrying amount of the related assets in certain limited circumstances. Those circumstances do not apply to the currencies participating in the changeover since the event of severe devaluation is incompatible with the required stability of participating currencies.~~

Effective Date: This Interpretation becomes effective on 1 January 2006. Changes in accounting policies shall be accounted for according to the requirements of SB-FRS 8.

~~[*] SB-FRS 10 (issued in 2003), paragraph 20, contains similar requirements.~~

[*] The accounting for hedges is now covered under SB-FRS 39 Financial Instruments: Recognition and Measurement. As INT SB-FRS 7 was issued before SB-FRS 39, the previous version of this Interpretation could refer only to the entity's own accounting policies on the matter.