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# ACCA F7

## Financial Reporting(INT.)

## 财务报告（国际会计准则）

## Chapter 20 Foreign currency transactions

ACCA Lecturer: Roy Wang

1. **Conversion gains and losses**
2. **Reporting at subsequent year ends**
3. **Recognition of exchange differences**

# Foreign currency transactions

Foreign currency transactions

# Foreign currency transactions

Transactions involving foreign currency are very common in practice.

- If a company trades overseas, it will buy or sell assets in foreign currencies.
- A company might have a subsidiary abroad (ie a foreign entity that it owns), and the subsidiary will trade in its own local currency.

The F7 exam will only be testing foreign currency in the context of single entities, so we will not be covering group aspects.

# Foreign currency transactions

## Conversion gains and losses

# Foreign currency transactions

**Conversion is the process of exchanging amounts of one foreign currency for another. For example,** suppose a US company buys a consignment of goods from a supplier in Germany. The order is placed on 1 May and the agreed price is €124,250. At the time of delivery the rate of foreign exchange was €2 to $1. The local company would record the amount owed in its books as follows.

- DEBIT Purchases (124,250 ÷ 2) $62,125
- CREDIT Payables $62,125

# Foreign currency transactions

When the US company comes to pay the supplier, it needs to obtain some foreign currency. By this time,mhowever, if the rate of exchange has altered to €2.05 to $1, the cost of raising €124,250 would be (÷ 2.05) $60,610. The company would need to spend only $60,610 to settle a debt for inventories 'costing‘ $62,125. The US company will record a profit on conversion (or exchange gain) of $1,515.

- DEBIT Payables $62,125
- CREDIT Cash $60,610
- CREDIT Profit on conversion $1,515

# Recognition

# Foreign currency transactions

IAS 21 states that a foreign currency **transaction** should be recorded, on initial recognition in the functional currency, by applying the exchange rate between the reporting currency and the foreign currency **at the date of the transaction to the foreign currency amount.**

An **average rate for a period may be used if exchange rates do not fluctuate significantly.**

# Foreign currency transactions

**Reporting at subsequent year ends**

# Foreign currency transactions

The following rules apply at each subsequent year end.

(a) Report foreign currency **monetary items using the closing rate**

(b) Report **non-monetary items (eg non-current assets, inventories) which are carried at historical cost in a foreign currency using the exchange rate at the date of the transaction (historical rate)**

(c) Report **non-monetary items which are carried at fair value in a foreign currency using the** exchange rates that existed **when the values were measured.**

# Foreign currency transactions

**Recognition of exchange differences**

# Foreign currency transactions

There are two situations to consider:

(a) The transaction is **settled in the same period as that in which it occurred: all the exchange** difference is recognised in that period.

(b) The transaction is **settled in a subsequent accounting period: the exchange difference recognised** in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.

In other words, where a monetary item has not been settled at the end of a period, it should be **restated using the closing exchange rate and any gain or loss taken to profit or loss.**

# Foreign currency transactions

Seattle Co, whose year-end is 31 December, buys some goods from Telomere SA of France on 30 September. The invoice value is €60,000 and is due for settlement in equal instalments on 30 November and 31 January. The exchange rate moved as follows.

| | €= $1 |
|---|---|
| 30 September | 1.60 |
| 30 November | 1.80 |
| 31 December | 1.90 |
| 31 January | 1.85 |

*Required*

State the accounting entries in the books of Seattle Co.

# Foreign currency transactions

The purchase will be recorded in the books of Seattle Co using the rate of exchange ruling on 30 September.

| | | | |
|---|---|---|---|
| DEBIT | Purchases | $37,500 | |
| CREDIT | Trade payables | | $37,500 |

Being the $ cost of goods purchased for €60,000 (€60,000 ÷ €1.60/$1)

On 30 November, Seattle Co must pay €30,000. This will cost €30,000 ÷ €1.80/$1 = $16,667 and the company has therefore made an exchange gain of $18,750 – $16,667 = $2,083.

| | | | |
|---|---|---|---|
| DEBIT | Trade payables | $18,750 | |
| CREDIT | Exchange gains: profit or loss | | $2,083 |
| CREDIT | Cash | | $16,667 |

# Foreign currency transactions

On 31 December, the year end, the outstanding liability will be recalculated using the rate applicable to that date: €30,000 ÷ €1.90/$1 = $15,789. A further exchange gain of $2,961 has been made and will be recorded as follows.

| | | | |
|---|---|---|---|
| DEBIT | Trade payables | $2,961 | |
| CREDIT | Exchange gains: profit or loss | | $2,961 |

The total exchange gain of $5,044 will be included in the operating profit for the year ending 31 December

On 31 January, Seattle Co must pay the second instalment of €30,000. This will cost them $16,216 (€30,000 ÷ €1.85/$1).

| | | | |
|---|---|---|---|
| DEBIT | Trade payables | $15,789 | |
| | Exchange losses: profit or loss | $427 | |
| CREDIT | Cash | | $16,216 |

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# Thank You!