Documents published to accompany

IFRIC 22

Foreign Currency Transactions and Advance Consideration

The text of the unaccompanied Interpretation, IFRIC 22, is contained in Part A of this edition. Its effective date when issued was 1 January 2018. The text of the Accompanying Guidance on IFRIC 22 is contained in Part B of this edition. This part presents the following document:

BASIS FOR CONCLUSIONS

Basis for Conclusions on IFRIC 22 *Foreign Currency Transactions and Advance Consideration*

This Basis for Conclusions accompanies, but is not part of, IFRIC 22.

Introduction

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 question asking how to determine the exchange rate to use in applying IAS 21 *The Effects of Changes in Foreign Exchange Rates* when recognising revenue. The question addressed a circumstance in which an entity receives advance consideration in a foreign currency. IAS 21 does not specifically address such a circumstance.

BC3 The Interpretations Committee noted that the feedback from its outreach on the question indicated that:

(a) the issue affects a number of jurisdictions, and particularly affects the construction industry.

(b) diverse reporting methods are applied. Some entities recognise revenue using the spot exchange rate between the functional currency and the foreign currency at the date of the receipt of the advance consideration and others use the exchange rate at the date that revenue is recognised.

BC4 To address the issue, in October 2015 the Interpretations Committee published a draft Interpretation *Foreign Currency Transactions and Advance Consideration* for public comment. It received 45 comment letters. The Interpretations Committee considered the comments received in developing this Interpretation.

Scope

Foreign currency transactions other than revenue transactions

BC5 The question received related specifically to revenue transactions. However, in discussing the issue, the Interpretations Committee noted that a similar question arises for other transactions when consideration is denominated in a foreign currency and is paid or received in advance. 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) receipt of some government grants.

BC6 In addition, the Interpretations Committee noted that IAS 21 applies to all foreign currency transactions, not only to revenue transactions in a foreign currency. Consequently, the Interpretations Committee decided that the Interpretation applies to a foreign currency transaction (or part of it) when an entity recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. Respondents to the draft Interpretation generally supported the scope proposed by the Interpretations Committee.

Income taxes and insurance contracts

BC7 The Interpretations Committee decided that an entity is not required to apply the Interpretation to income taxes, or to insurance contracts (including reinsurance contracts) that it issues or reinsurance contracts that it holds.

BC8 The Interpretations Committee concluded that it is important to avoid unintended consequences for income taxes because of the complexities that arise from the interplay with deferred tax. Similarly, the Interpretations Committee concluded that it is important to avoid unintended consequences for insurance contracts. The International Accounting Standards Board's project on Insurance Contracts is at an advanced stage and it would be inappropriate to require a change in accounting before the application of the forthcoming insurance contracts Standard.

Non-cash consideration

BC9 Advance consideration may be denominated 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.

BC10 IAS 21 applies to both cash and non-cash foreign currency transactions. Accordingly, the Interpretations Committee determined that the Interpretation applies to both cash and non-cash transactions when an entity recognises a non-monetary asset or non-monetary liability arising from advance consideration in a foreign currency.

Transactions measured at fair value on initial recognition

BC11 Paragraph 23(c) of IAS 21 requires an entity to translate non-monetary items measured at fair value in a foreign currency using the exchange rate at the date when the fair value was measured. Consequently, the Interpretations Committee decided that the Interpretation does not apply to foreign currency transactions for which the related asset, expense or income is initially measured at fair value.

BC12 The Interpretations Committee also decided the Interpretation does not apply to foreign currency transactions for which the related asset, expense or income is initially measured at the fair value of the consideration paid or received at a date other than the date of the transaction specified in this Interpretation. 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 transaction.

Monetary and non-monetary items

BC13 The payment or receipt of advance consideration generally gives rise to the recognition of a non-monetary asset or non-monetary liability. However, an advance payment or receipt could give rise to a monetary asset or liability instead of a non-monetary asset or liability.

BC14 When the asset or liability is a monetary item, paragraphs 28–29 of IAS 21 require an entity to recognise an exchange difference in profit or loss for any change in the exchange rate between the transaction date and the date of settlement of that asset or liability. Consequently, the question about which exchange rate to use on initial recognition of the related asset, expense or income arises only when the advance consideration gives rise to the recognition of a non-monetary asset or non-monetary liability. Accordingly, the Interpretations Committee decided that this Interpretation applies only in circumstances in which an entity recognises a non-monetary asset or non-monetary liability arising from advance consideration.

BC15 Some respondents to the draft Interpretation requested guidance in determining whether the payment or receipt of advance consideration gives rise to a monetary or non-monetary asset or liability. These respondents said that, for some transactions, this assessment can be difficult.

BC16 In considering the request, the Interpretations Committee noted that the Interpretation is not adding a new requirement to determine whether an item is monetary or non-monetary—this requirement already exists in IAS 21. The Interpretation simply clarifies which exchange rate to use for particular transactions. The Interpretations Committee decided that it was outside the scope of this Interpretation to provide application guidance on the definition of monetary and non-monetary items.

BC17 Nonetheless, the Interpretations Committee acknowledged that an entity may need to apply judgement in determining whether an item is monetary or non-monetary. It also noted references in Standards and *The Conceptual Framework for Financial Reporting* (the *Conceptual Framework*)[1] that may be helpful in determining whether an item is monetary or non-monetary. These references include:

1 References to the *Conceptual Framework for Financial Reporting* in this Basis for Conclusions are to the *Conceptual Framework for Financial Reporting*, issued in 2010 and in effect when the Interpretation was developed.

(a) paragraph 16 of IAS 21;

(b) paragraph AG11 of IAS 32 *Financial Instruments: Presentation*; and

(c) paragraph 4.17 of *The Conceptual Framework*.

Consensus

The date of the transaction

BC18 Paragraph 22 of IAS 21 defines the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of a foreign currency transaction as 'the date on which the transaction first qualifies for recognition in accordance with IFRSs'.

BC19 The Interpretations Committee observed that there could be two ways of identifying 'the transaction' for the purpose of determining the exchange rate to use on initial recognition:

(a) the 'one-transaction' approach—the receipt or payment of consideration and the transfer of the goods or services are all considered to be 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 applying the relevant Standards.

(b) the 'multi-transaction' approach—the receipt or payment of consideration and the transfer of the goods or services are considered to be separate transactions, each of which has its own 'date of the transaction' when it first qualifies for recognition applying the relevant Standards.

BC20 The one-transaction approach is consistent with the notion that purchases and sales represent exchange transactions, and 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 asset or non-monetary liability, that would determine the date of the transaction for the purpose of recognising the related asset, expense or income (or part of it).

BC21 The multi-transaction approach treats the transfer of goods or services and the receipt or payment of consideration as two separate transactions. This approach would result in a date of the transaction that is the same as the date of recognition of the related asset, expense or income (or part of it), regardless of the timing of the payment or receipt of consideration.

BC22 The Interpretations Committee decided that the one-transaction approach is a more appropriate interpretation of IAS 21 when the payment or receipt of advance consideration gives rise to a non-monetary asset or non-monetary liability. This is because:

(a) it reflects that an entity is typically no longer exposed to foreign exchange risk in respect of the transaction to the extent that it has received or paid advance consideration. After receipt of advance consideration in a foreign currency, the entity can decide whether to hold the foreign currency consideration and be exposed to foreign exchange risk. After payment of advance consideration in a foreign currency, 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 non-monetary liability) and the subsequent fulfilment of that obligation (which gives rise to income) are interdependent and are part of the same transaction.

(c) the right to receive assets, goods or services (reflected in the recognition of a non-monetary asset) and the receipt of those assets, goods or services are inherently interdependent.

(d) it is consistent with the treatment of non-monetary assets and non-monetary liabilities applying paragraph 23(b) of IAS 21, because an entity does not subsequently update the translated amounts of such items.

BC23 In addition, considering paragraph 22 of IAS 21, the Interpretations Committee concluded that, for a transaction to qualify for recognition in accordance with the Standards, an entity must record the transaction in its financial statements with a value. The Interpretations Committee observed that paragraph 4.46 of the *Conceptual Framework* 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'. Consequently, the Interpretations Committee concluded the date on which an entity first recognises the transaction in its financial statements with a value determines the date of the transaction. If an entity recognises a non-monetary asset or non-monetary liability arising from advance consideration, the date of initial recognition of that asset or liability is the date of the transaction. The date of initial recognition of the non-monetary asset or non-monetary liability is generally the date on which the entity pays or receives the advance consideration.

Multiple payments

BC24 If only part of the consideration is received or paid in advance, then an entity has initially recognised only part of the transaction as a non-monetary asset or non-monetary liability. In that case, applying this Interpretation, an entity determines the date of the transaction for only that part of the related asset, expense or income for which consideration has been received or paid in advance. If there are subsequent advance payments or receipts, the date(s) of the transaction for the remaining part(s) of the related asset, expense or income will be the date(s) on which the entity recognises those subsequent advance receipts or payments. Correspondingly, if part of the consideration is paid in arrears, the date(s) of the transaction for the remaining part(s) of the related asset, expense or income will be the date(s) on which the entity initially recognises that (those) part(s) of the asset, expense or income in its financial statements applying applicable Standards.

BC25 The Interpretations Committee observed that this treatment reflects that an entity typically has no foreign exchange risk in respect of foreign currency amounts already paid or received, but is still exposed to foreign exchange risk in respect of any unpaid consideration.

Embedded derivatives

BC26 The Interpretations Committee was asked to clarify how the Interpretation applies to an embedded derivative that requires separation at contract inception. The Interpretations Committee decided it was not necessary to clarify this matter in the Interpretation. The Interpretation Committee noted that paragraph 24 of IAS 21 requires an entity to determine the carrying amount of an item in conjunction with other relevant Standards. Consequently, an entity first evaluates transactions for embedded derivatives that require separation at contract inception before applying the requirements in IAS 21 or this Interpretation.

BC27 The Interpretations Committee further noted that, if an entity separately accounts for an embedded derivative, the requirements of the Interpretation apply to a remaining host contract denominated in a foreign currency when consideration has been paid or received in advance as they do to other such foreign currency transactions.

Illustrative examples

BC28 Some respondents to the draft Interpretation suggested including an example to illustrate how the Interpretation applies to transactions with a significant financing component. The Interpretations Committee decided not to include an example because it concluded that any such example would interpret other Standards.

Interaction with the presentation of exchange differences arising on monetary items

BC29 The Interpretations Committee considered the interaction of the Interpretation with the presentation of exchange differences on the settlement or retranslation of monetary items that, applying paragraphs 28–29 of IAS 21, an entity recognises in profit or loss in the period in which they arise.

BC30 The Interpretations Committee decided that presentation of exchange differences in profit or loss is outside the scope of the issue being addressed in the Interpretation. This is because the Interpretation addresses only how to determine the 'date of the transaction' for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income on the derecognition of a non-monetary asset or non-monetary liability arising from advance consideration in a foreign currency.

Transition

BC31 The Interpretations Committee observed that retrospective application of the Interpretation may be burdensome, in particular for foreign currency transactions involving purchases of assets. Consequently, the Interpretations Committee decided that, on initial application, entities should have the option not to retrospectively adjust assets, expenses and income (or parts of them) that had been recognised before the beginning of the reporting period in which the Interpretation is first applied or the beginning of a prior reporting period presented as comparative information in the period in which the Interpretation is first applied.

BC32 If an entity uses this option and applies the Interpretation prospectively as permitted in paragraph A2(b), the entity does not restate amounts recognised before either the beginning of the reporting period in which the entity first applies the Interpretation (if paragraph A2b(i) is applied) or the beginning of a prior reporting period presented as comparative information in the period in which the entity first applies the Interpretation (if paragraph A2b(ii) is applied).

First-time adopters

BC33 The Interpretations Committee received feedback that first-time adopters of IFRS Standards may also find retrospective application burdensome. Consequently, the Interpretations Committee decided that first-time adopters should not be required to apply the Interpretation to assets, expenses and income initially recognised before the date of transition to IFRS Standards. Accordingly, this Interpretation amends IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

