ASSURANCE AND ACCOUNTING

ASPE - IFRS: A Comparison

Foreign Exchange

In this publication we will examine the key differences between Accounting Standards for Private Enterprises (ASPE) and International Financial Reporting Standards (IFRS) related to foreign currency with a focus on:

- Determining functional currency;
- Translation of foreign currency transactions;
- Translation of financial statements of foreign operations; and
- Use of a presentation currency.

References

ASPE	IFRS
• Section 1651 – *Foreign Currency Translation*	• *IAS 21 – The Effects of Changes in Foreign Exchange Rates* • *IFRIC 22 - Foreign Currency Transactions and Advance Consideration*

Overview of Major Differences

While IFRS and ASPE are similar in some areas there are some differences in the guidance provided on foreign currency translation including:

- IFRS provides specific guidance on determining a reporting entity's functional currency while ASPE does not.
- ASPE classifies foreign operations into either integrated or self-sustaining while IFRS does not classify foreign operations into different categories.
- ASPE and IFRS take different approaches to the translation of foreign operations.
- IFRS provides guidance on translating a reporting entity's financial statements from the functional currency to a presentation currency while ASPE does not.

Scope

Section 1651, *Foreign Currency Translation*, and IAS 21, *The Effects of Changes in Foreign Exchange Rates*, are similar standards in that they both cover translation of foreign currency transactions and financial statements of foreign operations. However, there are some significant differences in the scope of each standard.

ASPE	IFRS
Section 1651 provides guidance on: • Translating transactions of a reporting entity that are denominated in a foreign currency; and • Translating the financial statements of a foreign operation for incorporation into the financial statements of a reporting entity. ASPE does not provide guidance on translating a reporting entity's results and financial position into a presentation currency.	IAS 21 provides guidance on: • Accounting for transactions and balances in foreign currencies, except for derivative transactions and balances within the scope of IFRS 9, *Financial Instruments* (refer to our ASPE-IFRS comparison publication on Financial Instruments for guidance on accounting for these items); • Translating the results and financial position of foreign operations that are included in the financial statements of the reporting entity either by consolidation or the equity method; and • Translating a reporting entity's results and financial position into a presentation currency.

Determination of Functional Currency

To enable translation of foreign currency transactions or foreign operations, both ASPE and IFRS require an assessment of the basis or unit of measure, or what is termed the functional currency under IFRS. However, the way in which these assessments are made are very different.

ASPE	IFRS
When a reporting entity prepares financial statements it is required to assess the basis or unit of measure for any foreign operations. However, the reporting entity is not explicitly required to assess the basis or unit of measure for its own financial results and position.	One of the fundamental requirements of IFRS is that when a reporting entity prepares financial statements each individual entity included in those statements, including the parent company, must determine its own functional currency and measure its own results and financial position in that currency. This explicit requirement applies whether the individual entity is a standalone entity, an entity with foreign operations (e.g. a parent company) or is actually the foreign operation (e.g. a subsidiary or branch).
ASPE refers to the unit or basis of measurement for the translation of assets, liabilities, revenues and expenses.	Functional currency is the currency of the primary economic environment in which the entity operates. The functional currency of an entity should reflect the underlying transactions, events and condition that are relevant to the entity.
A foreign operation is a subsidiary, division, branch, joint arrangement or similar type of entity that undertakes and/or records its economic activities in a currency other than the reporting currency of the reporting enterprise. ASPE divides foreign operations into two categories: integrated or self-sustaining. the method of translation of a foreign operation is dependent on this classification:	A foreign operation is an entity that is a subsidiary, associate, joint arrangement or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity. IFRS does not classify foreign operations into different categories. Instead, each entity included in the consolidated financial statements of the reporting entity must determine its own functional currency and measure

• An integrated foreign operation is financially or operationally interdependent with the reporting entity (e.g. a parent company) such that the exposure to exchange rate changes is similar to the exposure that would exist had the transactions and activities of the foreign operation been undertaken by the reporting entity itself. An integrated foreign operation's unit of measure is the same currency as the reporting entity. • A self-sustaining foreign operation is financially and operationally independent of the reporting entity such that the reporting entity's exposure to exchange rate changes is limited to its net investment in the foreign operation. A self-sustaining foreign operation's unit of measure is not the same as the reporting entity. Therefore, the foreign operation's financial statements need to be converted to the reporting currency, which is the reporting entity's unit of measure. The classification as an integrated or self-sustaining foreign operation is based on a professional judgment evaluation of the reporting entity's exposure to exchange rate changes taking into account the economic facts and circumstances specific to the foreign operation. Some considerations include: • Are the reporting entity's cash flows insulated from or affected by the day to day activities of the foreign operation? • Are sales prices for the foreign operation's products and services determined by local market forces or worldwide forces? • Where is the foreign operation's sales market – primarily outside or within the reporting entity's country? • Are labour, materials and other costs of products and / or services incurred outside or within the reporting entity's country? • Are the day-to-day activities of the foreign operation financed by its own operations or borrowings incurred locally, or by the reporting entity or within the reporting entity's country? • Is there a day-to-day interrelationship between the foreign operation and the reporting entity?	its own results and financial position in that currency. However, a foreign operation that is integral to the reporting entity (i.e. it carries on business as if it is an extension of the reporting entity's own operations), will always have the same functional currency as the reporting entity since it would operate in the same primary economic environment as the reporting entity. The determination of functional currency is based on the primarily economic environment in which the entity operates. The following factors are to be considered in determining an entity's functional currency: • The currency that mainly influences sales prices for goods and services (often the currency in which sales prices for its goods and services are denominated and settled); • The currency of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services; and • The currency that mainly influences labour, material and other costs of providing goods or services (often the currency in which these costs are denominated and settled). Only if the above indicators are mixed or unclear will an entity need to look to the following factors, which may also provide evidence of an entity's functional currency. These factors include: • The currency in which funds from financing activities (i.e. issuing debt and equity instruments) are generated; and • The currency in which receipts from operating activities are usually retained. Furthermore, the following additional factors may also be considered: • Are the activities of the foreign operation carried out as an extension of the reporting entity, or with a significant degree of autonomy? • Are transactions with the reporting entity a high or a low proportion of the foreign operation's activities? • Are cash flows from the activities of the foreign operation directly affecting the cash flows of the reporting entity? Are they readily available for remittance to the reporting entity? • Are cash flows from the activities of the foreign operation sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity?
Whether a foreign operation is integrated or self-sustaining should not be changed unless there are significant changes in the economic facts and circumstances. When a change occurs, the change should be accounted for on a prospective basis.	Once an entity's functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. Similar to ASPE, this change should be accounted for on a prospective basis.

Translation of a Foreign Operation

The approach of ASPE and IFRS in translating the results and financial position of a foreign operation into a presentation currency are different.

<table>
<tr><th>ASPE</th><th>IFRS</th></tr>
<tr><td>For integrated foreign operations, or those in highly inflationary economies, the temporal method of translation is used, which requires:

Monetary items to be translated at the exchange rate in effect at the balance sheet date;
Non-monetary items to be translated at historical exchange rates, unless such items are carried at market, in which case they are translated at the exchange rate in effect at the balance sheet date;
Revenue and expense items are translated at the exchange rate in effect on the dates they occur;
Depreciation or amortization of assets translated at historical exchange rates is translated at the same exchange rates as the assets to which it relates; and
Exchange gains or losses arising on translation of monetary items or non-monetary items carried at market are recognized in net income for the current period.

Using this method retains the basis of measurement in the reporting entity’s currency.

For self-sustaining foreign operations the current rate method of translation is used, which requires:

Assets and liabilities to be translated using the exchange rate in effect at the balance sheet date;
Revenue and expense items (including depreciation and amortization) are translated at the exchange rate in effect on the dates on which such items are recognized in income during the period; and
Exchange gains or losses arising on translation are recognized in a separate component of shareholder’s equity.

Using the current rate method, transactions and balances retains the basis of measurement in terms of the foreign currency (the currency of the foreign operation’s financial statements).</td>
<td>When the reporting entity prepares consolidated financial statements, the results and financial position of each individual entity included in the consolidated financial statements must be translated from the individual entity’s functional currency into the functional currency of the reporting entity.

The translation of foreign operations with a different functional currency is done using the current rate method, which requires:

Assets and liabilities for each balance sheet presented (i.e. including comparatives) to be translated at the closing rate at the date of that balance sheet;
Income and expenses for each income statement (i.e. including comparatives) to be translated at exchange rates at the dates of the transactions; and
All resulting exchange differences to be recognized as a separate component of other comprehensive income (OCI).
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<tr><td>On the disposal of a reporting entity’s entire interest in a self-sustaining foreign operation, the exchange gains and losses previously accumulated in a separate component of shareholder’s equity are recognized in net income as part of the total gain or loss on disposal. Additionally, previously accumulated gains and losses are treated the same way on a reporting entity’s disposal of:

Its entire interest or a partial interest that results in a loss of control in a subsidiary that includes a foreign operation;
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<td>On the disposal of an entity’s entire interest in a foreign operation, the cumulative amount of the exchange differences previously recognized in accumulated OCI relating to that foreign operation are recognized in profit or loss when the gain or loss on disposal is recognized. In addition, the following partial disposals are accounted for as disposals:

When the partial disposal involves the loss of control of a subsidiary that includes a foreign operation, regardless of whether the entity retains
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• A portion of its investment in a significant influence investee accounted for by the equity method that results in a loss of significant influence; and • A portion of its investment in a jointly controlled enterprise that includes a foreign operation that results in a loss of joint control. On disposal of a reporting entity's entire interest or partial interest that results in a loss of control, in a subsidiary that includes a foreign operation, the accumulated amount of exchange gains and losses attributable to the non-controlling interest is derecognized, but not recognized in net income. When there is only a partial disposal and no loss of control, the entity reattributes the proportionate share of the cumulative amount of the exchange gains and losses previously recognized in a separate component of shareholder's equity to the non-controlling interests in that foreign operation. On any other partial disposal of a foreign operation, the entity reclassifies to net income only the proportionate share of the cumulative amount of the exchange gains and losses previously recognized in a separate component of shareholder's equity. A reduction in the carrying amount of a self-sustaining foreign operation due to operating, other losses, or impairment, does not constitute a disposal or partial disposal and no part of the foreign exchange gains or losses previously recognized in a separate component of shareholder's equity is recognized in net income as a result of the reduced carrying amount.	a non-controlling interest in the former subsidiary; and • When the retained interest after the partial disposal of an interest in a joint arrangement or an associate that includes a foreign operation is a financial asset that includes a foreign operation. On disposal of a subsidiary that includes a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation that have been attributed to the non-controlling interests is derecognized, but is not reclassified to profit or loss. When there is only a partial disposal, the entity reattributes the proportionate share of the cumulative amount of the exchange differences previously recognized in OCI to the non-controlling interests in that foreign operation. On any other partial disposal of a foreign operation, the entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognized in OCI.

Translation of Foreign Currency Transactions

ASPE and IFRS are similar in the guidance provided on translating foreign currency transactions, however, there are some differences in the treatment of gains and losses as outlined below.

ASPE	IFRS
At the transaction date, each asset, liability, revenue or expense should be translated using the exchange rate in effect at that date.	Like ASPE, at the transaction date, each asset, liability, revenue or expense should be translated using the exchange rate in effect at that date. IFRIC 22 addresses 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 (or part of it) on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. The date of the transaction is the date on which an entity initially recognizes the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration. If there are multiple payments or receipts in advance, the entity

	shall determine a date of the transaction for each payment or receipt of advance consideration. Refer to BDO's IFRS at A Glance: IFRIC 22 – *Foreign Currency Transactions and Advance Consideration* for a summary of the guidance.
At each balance sheet date: • Monetary items denominated in a foreign currency are translated to reflect the exchange rate at the balance sheet date; • Non-monetary items carried at market are translated to reflect the exchange rate at the balance sheet date; and • Non-monetary items carried at historical cost are translated using the exchange rate at the date of the transaction.	Similar to ASPE, at each balance sheet date: • Foreign currency monetary items are translated to reflect the exchange rate at the balance sheet date; • Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date the fair value was determined, which in many, but not all, cases will be the rate at the balance sheet date; and • Non-monetary items measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.
Any exchange gain or loss arising on translation or settlement of a foreign currency denominated monetary item is recognized in net income for the current period unless the monetary item forms part of the reporting entity's net investment in a self-sustaining foreign operation. In that case, the reporting entity's financial statements record the exchange gain or loss as a separate component of shareholder's equity.	Exchange differences arising on the settlement or translation of monetary items are recognized in profit and loss in the period they arise unless the monetary item forms part of the reporting entity's net investment in a foreign operation. In this case, the group consolidated financial statements record the exchange difference in OCI and Accumulated OCI. The exchange gain or loss is only transferred to profit or loss on disposal, in part or in full, of the net investment.
Any exchange gain or loss arising on translation or settlement of a foreign currency denominated non-monetary item carried at market is recognized in net income for the current period.	The recognition of exchange gains or losses arising on non-monetary items is linked to the recognition of gains or losses of the non-monetary item itself. If the non-monetary item gain or loss is recognized in profit and loss, then any foreign exchange gain or loss on that non-monetary item is also recorded in profit and loss. If the non-monetary item gain or loss is recognized directly in OCI, then any foreign exchange gain or loss on that non-monetary item is also recorded in OCI.

Use of a Presentation Currency other than the Functional Currency

ASPE and IFRS allow a reporting entity to present its financial statements in a currency that is different from its measurement or functional currency, referred to as the presentation or reporting currency. However, the guidance on how the entity's financial statements are translated into the presentation currency differs between ASPE and IFRS.

ASPE	IFRS
When an entity presents financial statements in a currency other than the functional currency, ASPE does not provide guidance on how the financial statements should be translated into the reporting currency. However, we believe translation using the current rate	The method of translation of the functional currency results and financial position, including comparatives, of an entity into a different presentation currency is dependent on whether or not the functional currency is the currency of a hyper inflationary economy.

method, which is the approach used under IFRS, is acceptable.	Where the entity's functional currency is not that of a hyper inflationary economy the results and financial position of the entity are translated into a different presentation currency using the current rate method.

Conclusion

The principles related to the translation of foreign currency transactions and translation of foreign operations under ASPE and IFRS have some similarities. However, there are also some clear differences, especially in relation to the approach taken by each in making the translation from a foreign currency to a measurement, functional or presentation currency.

If you require further guidance on accounting for foreign currency translations under ASPE or IFRS please contact your local BDO Canada LLP office. If you are considering the adoption of a new standard, learn how our BDO Accounting Advisory Services Team can help you with the transition.

To learn more about the differences between standards, view our ASPE-IFRS: A Comparison Series.