LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD

MASB Standard 6

The Effects of Changes in Foreign Exchange Rates

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The Effects of Changes in Foreign Exchange Rates

Contents

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The standards, which have been set in bold type, should be read in the context of the background materials and implementation guidance in this Standard, and in the context of the Foreword to MASB Standards. MASB Standards are not intended to apply to immaterial items.

Objective

An enterprise may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In order to include foreign currency transactions and foreign operations in the financial statements of an enterprise, transactions must be expressed in the enterprise's reporting currency and the financial statements of foreign operations must be translated into the enterprise's reporting currency.

The principal issues in accounting for foreign currency transactions and foreign operations are to decide which exchange rate to use and how to recognise in the financial statements the financial effect of changes in exchange rates.

Scope

1. **This Standard should be applied:**

(a) **in accounting for transactions in foreign currencies; and**

(b) **in translating the financial statements of foreign operations that are included in the financial statements of the enterprise by consolidation, proportionate consolidation or by the equity method.**

2. This Standard does not deal with hedge accounting for foreign currency items other than the classification of exchange differences arising on a foreign currency liability accounted for as a hedge of a net investment in a foreign entity. Other aspects of hedge accounting, including the criteria for the use of hedge accounting, will be dealt with in a proposed MASB Standard on Financial Instruments. This Standard, however, does not preclude the use of hedge accounting of transactions or exposed positions covered by hedging instruments.

3. This Standard supersedes MASB Approved Accounting Standard IAS 21, Accounting for the Effects of Changes in Foreign Exchange Rates, and International Accounting Standard IAS 21 (revised), The Effects of Changes in Foreign Exchange Rates, issued previously by the Malaysian professional accountancy bodies.

4. This Standard does not specify the currency in which an enterprise presents its financial statements. However, under the provisions of 6(1) of the Ninth Schedule of the Companies Act 1965, all amounts in the profit and loss (income statement) and balance sheet shall be quoted in Malaysian currency, and not otherwise.

5. This Standard does not deal with the restatement of an enterprise's financial statements from its reporting currency into another currency for the convenience of users accustomed to that currency or for similar purposes.

6. This Standard does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency and the translation of cash flows of a foreign operation (see MASB 5, Cash Flow Statements).

Definitions

7. The following terms are used in this Standard with the meanings specified:

Closing rate is the spot exchange rate at the balance sheet date.

Exchange difference is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

Exchange rate is the ratio for exchange of two currencies.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Foreign currency is a currency other than the reporting currency of an enterprise.

Foreign operation is a subsidiary, associate, joint venture or branch of the reporting enterprise, the activities of which are based or conducted in a country other than the country of the reporting enterprise.

Foreign entity is a foreign operation, the activities of which are not an integral part of those of the reporting enterprise.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Net investment in a foreign entity is the reporting enterprise's share in the net assets of that entity.

Reporting currency is the currency used in presenting the financial statements.

Foreign Currency Transactions

Initial Recognition

8. A foreign currency transaction is a transaction which is denominated in or requires settlement in a foreign currency, including transactions arising when an enterprise either:

   (a) buys or sells goods or services whose price is denominated in a foreign currency;

   (b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency;

   (c) becomes a party to an unperformed foreign exchange contract; or

   (d) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

9. A foreign currency transaction should be recorded, on initial recognition in the reporting currency, by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the transaction.

10. The exchange rate at the date of the transaction is often referred to as the spot rate. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Reporting at Subsequent Balance Sheet Dates

11. At each balance sheet date:

(a) foreign currency monetary items should be reported using the closing rate, except when there are related or matching forward contracts in respect of trading transactions, in which case, the rates of exchange specified in those contracts should be used;

(b) non-monetary items which are carried in terms of historical cost denominated in a foreign currency should be reported using the exchange rate at the date of the transaction; and

(c) non-monetary items which are carried at fair value denominated in a foreign currency should be reported using the exchange rates that existed when the values were determined.

12. The carrying amount of an item is determined in accordance with the relevant MASB Standards. For example, certain financial instruments and property, plant and equipment may be measured at fair value or at historical cost. Whether the carrying amount is determined based on historical cost or fair value, the amounts so determined for foreign currency items are then reported in the reporting currency in accordance with this Standard.

Recognition of Exchange Differences

13. Paragraphs 15 to 18 set out the accounting treatment required by this Standard in respect of exchange differences on foreign currency transactions. These paragraphs include the benchmark treatment for exchange differences that result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of assets invoiced in a foreign currency. The allowed alternative treatment for such exchange differences is set out in paragraph 21.

14. This Standard does not deal with hedge accounting for foreign currency items other than the classification of exchange differences arising on a foreign currency liability accounted for as a hedge of a net investment in a foreign entity. Other aspects of hedge accounting, including the criteria for the use of hedge accounting and requirements for the

recognition of exchange differences and the discontinuance of hedge accounting, will be dealt with in a proposed MASB Standard on Financial Instruments: Recognition and Measurement.

15. Exchange differences arising on the settlement of monetary items or on reporting an enterprise's monetary items at rates different from those at which they were initially recorded during the period, or reported in previous financial statements, should be recognised as income or as expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraphs 17 and 19.

16. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of any monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when 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.

Net Investment in a Foreign Entity

17. Exchange differences arising on a monetary item that, in substance, forms part of an enterprise's net investment in a foreign entity should be classified as equity in the enterprise's financial statements until the disposal of the net investment, at which time they should be recognised as income or as expenses in accordance with paragraph 37.

18. An enterprise may have a monetary item that is receivable from, or payable to, a foreign entity. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension to, or deduction from, the enterprise's net investment in that foreign entity. Such monetary items may include long-term receivables or loans but do not include trade receivables or trade payables.

19 Exchange differences arising on a foreign currency liability accounted for as a hedge of an enterprise's net investment in a foreign entity should be classified as equity in the enterprise's financial statements until the disposal of the net investment, at which time they should be recognised as income or as expenses in accordance with paragraph 37.

Accordingly, the enterprise should denominate its foreign equity investments in the appropriate foreign currencies and translate the carrying amounts at the closing rate. In order for the resultant exchange differences to be taken to equity and offset against the exchange gains or losses on the foreign currency liability, the following conditions must apply:

(i) in any accounting period, exchange differences on the foreign currency liability should be offset only to the extent of exchange differences arising on the foreign equity investments;

(ii) the related foreign currency liability should not exceed in aggregate, the total amount of cash that the investments are expected to be able to realise, whether from profits or otherwise; and

(iii) the accounting treatment adopted should be applied consistently from period to period.

20. For the purposes of paragraphs 17 and 19, foreign entity includes other investments as defined under MASB Approved Accounting Standard IAS 25, Accounting For Investments.

Allowed Alternative Treatment

The benchmark treatment for exchange differences dealt with in paragraph 21 is set out in paragraph 15.

21. Exchange differences may result from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset invoiced in a foreign currency. Such exchange differences should be included in the carrying amount of the related asset, provided that the adjusted carrying amount does not exceed the lower of the replacement cost and the amount recoverable from the sale or use of the asset.

22. Exchange differences are not included in the carrying amount of an asset when the enterprise is able to settle or hedge the foreign currency liability arising on the acquisition of the asset. However, exchange losses are part of the directly attributable costs of the asset when the liability cannot be settled and there is no practical means of hedging, for example when, as a result of exchange controls, there is a delay in obtaining

foreign currency. Therefore, under the allowed alternative treatment, the cost of an asset invoiced in a foreign currency is regarded as the amount of reporting currency that the enterprise ultimately has to pay to settle its liabilities arising directly on the recent acquisition of the asset.

Financial Statements of Foreign Operations

Classification of Foreign Operations

23. The method used to translate the financial statements of a foreign operation depends on the way in which it is financed and operates in relation to the reporting enterprise. For this purpose, foreign operations are classified as either "foreign operations that are integral to the operations of the reporting enterprise" or "foreign entities".

24. A foreign operation that is integral to the operations of the reporting enterprise carries on its business as if it was an extension of the reporting enterprise's operations. For example, such foreign operations might only sell goods imported from the reporting enterprise and remit the proceeds to the reporting enterprise. In such cases, a change in the exchange rate between the reporting currency and the currency in the country of foreign operation has an almost immediate effect on the reporting enterprise's cash flow from operations. Therefore, the change in the exchange rate affects the individual monetary items held by the foreign operation rather than the reporting enterprise's net investment in that operation.

25. In contrast, a foreign entity accumulates cash and other monetary items, incurs expenses, generates income and perhaps arranges borrowings, all substantially in its local currency. It may also enter into transactions in foreign currencies, including transactions in the reporting currency. When there is a change in the exchange rate between the reporting currency and the local currency, there is little or no direct effect on the present and future cash flows from operations of either the foreign entity or the reporting enterprise. The change in the exchange rate affects the reporting enterprise's net investment in the foreign entity rather than the individual monetary and non-monetary items held by the foreign entity.

26. The following are indications that a foreign operation is a foreign entity rather than a foreign operation that is integral to the operations of the reporting enterprise:

(a) while the reporting enterprise may control the foreign operation, the activities of the foreign operation are carried out with a significant degree of autonomy from those of the reporting enterprise;

(b) transactions with the reporting enterprise are not a high proportion of the foreign operation's activities;

(c) the activities of the foreign operation are financed mainly from its own operations or local borrowings rather than from the reporting enterprise;

(d) costs of labour, material and other components of the foreign operation's products or services are primarily paid or settled in the local currency rather than in the reporting currency;

(e) the foreign operation's sales are mainly in currencies other than the reporting currency; and

(f) cash flows of the reporting enterprise are insulated from the day-to-day activities of the foreign operation rather than being directly affected by the activities of the foreign operation.

The appropriate classification for each operation can, in principle, be established from factual information related to the indicators listed above. In some cases, the classification of a foreign operation as either a foreign entity or an integral operation of the reporting enterprise may not be clear, and judgement is necessary to determine the appropriate classification.

Foreign Operations that are Integral to the Operations of the Reporting Enterprise

27. The financial statements of a foreign operation that is integral to the operations of the reporting enterprise should be translated using the standards and procedures in paragraphs 8 to 22 as if the transactions of the foreign operation had been those of the reporting enterprise itself.

28. The individual items in the financial statements of the foreign operation are translated as if all its transactions had been entered into by the reporting enterprise itself. The cost and depreciation of property, plant and equipment is translated using the exchange rate at the date of purchase of the asset or, if the asset is carried at fair value, using the rate that existed on the date of the valuation. The cost of inventories is

translated at the exchange rates that existed when those costs were incurred. The recoverable amount or realisable value of an asset is translated using the exchange rate that existed when the recoverable amount or net realisable value was determined. For example, when the net realisable value of an item of inventory is determined in a foreign currency, that value is translated using the exchange rate at the date as at which the net realisable value is determined. The rate used is, therefore, usually the closing rate. An adjustment may be required to reduce the carrying amount of an asset in the financial statements of the reporting enterprise to its recoverable amount or net realisable value even when no such adjustment is necessary in the financial statements of the foreign operation. Alternatively, an adjustment in the financial statements of the foreign operation may need to be reversed in the financial statements of the reporting enterprise.

29. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during the period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is unreliable.

Foreign Entities

30. In translating the financial statements of a foreign entity for incorporation in its financial statements, the reporting enterprise should use the following procedures:

(a) the assets and liabilities, both monetary and non-monetary, of the foreign entity should be translated at the closing rate;

(b) income and expense items of the foreign entity should be translated at exchange rates at the dates of the transactions, except when the foreign entity reports in the currency of a hyperinflationary economy, in which case income and expense items should be translated at the closing rate; and

(c) all resulting exchange differences should be classified as equity until the disposal of the net investment.

31. For practical reasons, a rate that approximates the actual exchange rates, for example an average rate for the period, is often used to translate income and expense items of a foreign operation.

32. The translation of the financial statements of a foreign entity results in the recognition of exchange differences arising from:

(a) translating income and expense items at the exchange rates at the dates of transactions and assets and liabilities at the closing rate;

(b) translating the opening net investment in the foreign entity at an exchange rate different from that at which it was previously reported; and

(c) other changes to equity in the foreign entity.

These exchange differences are not recognised as income or expenses for the period because the changes in the exchange rates have little or no direct effect on the present and future cash flows from operations of either the foreign entity or the reporting enterprise. When a foreign entity is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and reported as part of, the minority interest in the consolidated balance sheet.

33. Any goodwill arising on the acquisition of a foreign entity and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign entity are treated as either :

(a) assets and liabilities of the foreign entity and translated at the closing rate in accordance with paragraph 30; or

(b) assets and liabilities of the reporting entity which either are already expressed in the reporting currency or are non-monetary foreign currency items which are reported using the exchange rate at the date of the transaction in accordance with paragraph 11(b).

34. The incorporation of the financial statements of a foreign entity in those of the reporting enterprise follows normal consolidation procedures, such as the elimination of intra-group balances and intra-group transactions of a subsidiary. (See MASB ED 9, Consolidated Financial Statements and Investments in Subsidiaries and MASB ED 14, Financial Reporting of Interests in Joint Ventures). However, an exchange difference arising on an intra-group monetary item, whether short-term or long-term, cannot be eliminated against a corresponding amount arising on other intra-group balances because the monetary item represents a commitment to convert one currency into another and exposes the reporting enterprise to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of

the reporting enterprise, such an exchange difference continues to be recognised as income or an expense or, if it arises from the circumstances described in paragraph 17 and 19, it is classified as equity until the disposal of the net investment.

35. When the financial statements of a foreign entity are drawn up to a different reporting date from that of the reporting enterprise, the foreign entity often prepares, for purposes of incorporation in the financial statements of the reporting enterprise, statements as at the same date as the reporting enterprise. When it is impracticable to do this, MASB ED 9, Consolidated Financial Statements and Investments in Subsidiaries, allows the use of financial statements drawn up to a different reporting date provided that the difference is no greater than three months. In such a case, the assets and liabilities of the foreign entity are translated at the exchange rate at the balance sheet date of the foreign entity. Adjustments are made when appropriate for significant movements in exchange rates up to the balance sheet date of the reporting enterprise in accordance with MASB ED 9, Consolidated Financial Statements and Investments in Subsidiaries and MASB ED 10, Investments in Associates.

36. Enterprises are encouraged that when the financial statements of a foreign entity that reports in the currency of a hyperinflationary economy are to be translated into the reporting currency of the reporting enterprise, the standards and procedures prescribed based upon international best practice on Financial Reporting in Hyperinflationary Economies should be used. When the economy ceases to be hyperinflationary and the foreign entity discontinues the preparation and presentation of financial statements prepared in accordance with the said international best practice, it should use the amounts expressed in the measuring unit current at the date of discontinuation as the historical costs for translation into the reporting currency of the reporting enterprise.

Disposal of a Foreign Entity

37. On the disposal of a foreign entity, the cumulative amount of the exchange differences which have been deferred and which relate to that foreign entity should be recognised as income or as expenses in the same period in which the gain or loss on disposal is recognised.

38. An enterprise may dispose of its interest in a foreign entity through sale, liquidation, repayment of share capital, or abandonment of all, or part of, that entity. The payment of a dividend forms part of a disposal

only when it constitutes a return of the investment. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a foreign entity does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised at the time of a write-down.

Change in the Classification of a Foreign Operation

39. When there is a change in the classification of a foreign operation, the translation procedures applicable to the revised classification should be applied from the date of the change in the classification.

40. A change in the way in which a foreign operation is financed and operates in relation to the reporting enterprise may lead to a change in the classification of that foreign operation. When a foreign operation that is integral to the operations of the reporting enterprise is reclassified as a foreign entity, exchange differences arising on the translation of non-monetary assets at the date of the reclassification are classified as equity. When a foreign entity is reclassified as a foreign operation that is integral to the operation of the reporting enterprise, the translated amounts for non-monetary items at the date of the change are treated as the historical cost for those items in the period of change and subsequent periods. Exchange differences which have been deferred are not recognised as income or expenses until the disposal of the entity.

All Changes in Foreign Exchange Rates

Tax Effects of Exchange Differences

41. Gains and losses on foreign currency transactions and exchange differences arising on the translation of the financial statements of foreign operations may have associated tax effects which are accounted for in accordance with MASB Approved Accounting Standard IAS 12, Accounting for Taxes on Income.

Disclosure

42. An enterprise should disclose:

(a) the amount of exchange differences included in the net profit or loss for the period. In addition, either on the face of, or in notes to, the income statement, it should disclose exchange differences included in the income:

(i) **gains and losses realised in the period from currency transactions; and**

(ii) **unrealised gains and losses from foreign exchange translations;**

(b) **net exchange differences classified as equity as a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period;**

(c) **the amount of exchange differences arising during the period which is included in the carrying amount of an asset in accordance with the allowed alternative treatment in paragraph 21; and**

(d) **the closing rates used in translation.**

43. When there is a change in the classification of a significant foreign operation, an enterprise should disclose:

(a) **the nature of the change in classification;**

(b) **the reason for the change;**

(c) **the impact of the change in classification on shareholders' equity; and**

(d) **the impact on net profit or loss for each prior period presented had the change in classification occurred at the beginning of the earliest period presented.**

44. An enterprise should disclose the method selected in accordance with paragraph 33 to translate goodwill and fair value adjustments arising on the acquisition of a foreign entity.

45. An enterprise discloses the effect on foreign currency monetary items or on the financial statements of a foreign operation of a change in exchange rates occurring after the balance sheet date if the change is of such importance that non-disclosure would affect the ability of users of the financial statements to make proper evaluations and decisions (see MASB Approved Accounting Standard IAS 10, Contingencies and Events Occurring after Balance Sheet Date).

46. An enterprise is also encouraged to disclose:

    (a) its policy for foreign currency risk management; and

    (b) as at balance sheet date, in aggregate for each foreign currency, the amounts payable or receivable in a foreign currency in the case of non-current assets and non-current liabilities to the extent that they are not effectively hedged to a date at least 12 months after balance sheet date.

Transitional Provisions

47. The provisions of this Standard, with respect to the treatment of exchange differences, represent a departure from previously permitted practice under MASB Approved Accounting Standard IAS 21, Accounting for the Effects of Changes in Foreign Exchange Rates (see paragraph 31 of that Standard).

48. In light of the comments received during the exposure period, the MASB has decided to disallow the deferral and amortisation of exchange differences (gains or losses) arising on reporting an enterprise's long-term foreign currency monetary items at rates different from those at which they were presented in the previous period. The MASB has provided a transitional period for enterprises to change from the previously permitted treatment of deferral and amortisation of such exchange differences. The transitional period provided takes cognizance of the structural distortion to the economic and operating environment prevailing currently in Malaysia. Such distortions are not easily anticipated in the development of financial reporting standards. The Board is of the opinion that some aspects of the economic structural distortions impinge upon the assumptions and principles that underpin the MASB's A Proposed Framework for the Preparation and Presentation of Financial Statements and the standards derived from them. As a consequence, the Board believes it is appropriate to provide a transitional period for the reporting of deferred exchange differences. The transitional provisions are set out below.

49. The treatment of exchange differences on reporting an enterprise's long-term foreign currency monetary items at rates different from those at which they were recorded during the period or reported in previous financial statements, as set out in paragraph 15, need not be complied with until financial periods commencing on or after 1 July 2001. Therefore, in the transitional period enterprises may

continue to defer and amortise exchange differences arising on translation of long-term foreign currency monetary items. Where an enterprise applies the transitional provision in the preparation of its accounts it should disclose the accounting policy for the treatment of exchange differences arising from translation of foreign currency monetary items. Further, where an enterprise avails itself of the transitional provision, it should disclose, by way of note, the financial effects of the treatment on its financial statements for the period.

50. **For periods beginning on or after 1 July 2001, an enterprise should apply the provisions of paragraph 15 of this Standard with respect to the treatment of exchange differences on translation of long-term foreign currency monetary items in the preparation of its financial statements. In the application of the new provisions of this Standard, an enterprise should apply the treatment as set out in MASB 3, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies. This change in accounting policy should be accounted for retrospectively.**

51. **Irrespective of the transitional provision above, an enterprise that applies this Standard which constitutes a change in accounting policy, should adjust its financial statements in accordance with MASB 3, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies. The enterprise should, except when the amount is not reasonably determinable, classify separately and disclose the cumulative balance, at the beginning of the period, of exchange differences that were deferred and classified as equity in previous periods.**

Effective Date

52. **This MASB Standard becomes operative for financial statements covering periods beginning on or after 1, July 1999.**

Appendix 1

Compliance with International Accounting Standards

The requirements of this MASB Standard are consistent, in all material respects, with International Accounting Standard IAS 21 (revised), The Effects of Changes in Foreign Exchange Rates, except for:

1) This MASB Standard permits a limited aspect of hedge accounting to be applied to trading transactions covered by forward exchange contracts, as well as foreign currency liabilities and other financial instruments which are designated as, and which provide an effective hedge of, net investments in foreign entities and foreign equity investments.

2) This Standard places extra conditions for the treatment of exchange differences in equity and their off-setting. The Standard also requires further disclosures of items relating to exchange differences included in the income statement. These exchange differences should be identified according to gains or losses realised in the period from currency transactions, and unrealised gains or losses from foreign exchange translations.