

Also refer: NZ IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* (for entities that apply NZ IAS 39), NZ IFRIC 22 *Foreign Currency Transactions and Advance Consideration*

**FUNCTIONAL CURRENCY**

An entity's functional currency is the currency of the primary economic environment in which it operates.

Determine functional currency of each entity within a group - currency of primary economic environment in which entity operates.

**START**

**Primary factors**  
When determining the appropriate functional currency, the following factors are considered:

- Currency influencing sales prices for goods and services.
- Currency of country whose competitive forces and regulations determine sale prices.
- Currency mainly influencing input costs.

**Secondary factors**  
The primary indicators may be determinative. However, the following two indicators serve as supporting evidence.

Currency in which funds/receipts:

- from financing activities are generated
- from operating activities are retained.

**Is the entity a foreign operation?**

If yes, is the foreign operation 'integral' to its 'parent'? That is, does it carry on business as if it is an extension of the parent's own operations?

If it is 'integral' to its 'parent', the foreign operation has the same functional currency as the parent.

(Parent: the entity that has the foreign operation as its subsidiary, branch associate or joint arrangement).

**FOREIGN CURRENCY TRANSACTIONS**

Initial recognition  
Spot rate at transaction date.

Subsequent measurement

**FUNCTIONAL CURRENCY ESTABLISHED**

**CONSOLIDATION OF FOREIGN ENTITIES AND TRANSLATION OF FINANCIAL STATEMENTS TO A PRESENTATION CURRENCY**

**Translation method:**

- Assets & Liabilities - closing rate.
- Income and expenses - rate at transaction date (for practical purposes a monthly or quarterly rate might approximate the transaction date rates.).
- Resulting exchange differences recognised in other comprehensive income (foreign currency translation reserve).

**Monetary items**

Units of currency held and assets/ liabilities to be received/paid in a fixed or determinable amount of money.

- Translated at closing rate at reporting date.
- Gain or loss recognised in profit or loss.

**Non-monetary items**

- Rate at transaction date (if item at historical cost).
- Rate at revaluation date (if item carried at revalued amount).

**Impairment test**  
Measure non-monetary assets at the lower of:

- Carrying amount x historical cost; or
- Net realisable value/recoverable amount x closing rate at the end of the period.

Translation gains or losses on asset/liability recognised in profit or loss.

**Loan forming part of net investment in subsidiary**

Exchange gains and losses to equity on consolidation only. Recorded in profit or loss in separate (entity only) financial statements.

**Disposal of a subsidiary**

The cumulative amount of exchange differences that was recognised in equity is reclassified to profit or loss (recycled).

**General principle**  
Foreign exchange gain or loss to profit or loss.

**Exception**  
Where gain or loss on non-monetary item is recognised in equity, the foreign exchange gain or loss is also recognised in equity.

**KEY PRINCIPLES**

- No need to present financial statements in functional currency. A presentation currency can be selected.
- Accounting records must be kept in functional currency.
- A group does not have a functional currency. Functional currency is assessed separately for each entity in the group.

**TIER 2 NZ IFRS RDR REPORTERS**

NZ IFRS RDR Reporters must comply fully with the recognition and measurement principles of NZ IAS 21. However, there are certain disclosure exemptions available.

Although every effort is made to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular facts and circumstances of the situation.  
© 2020 BDO New Zealand Limited. All Rights Reserved. For more information visit [www.bdo.nz](http://www.bdo.nz).