

IFRS in Focus

IFRS Interpretations Committee issues Draft Interpretation on Foreign Currency Transactions and Advance Consideration

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This edition of IFRS in Focus outlines the proposals set out in the recent draft IFRIC Interpretation DI/2015/2 *Foreign Currency Transactions and Advance Consideration* (the "draft Interpretation") which was issued by the IFRS Interpretations Committee in October 2015 for public comment.

The Bottom Line

- The proposals would provide guidance on how an entity should determine the date of a transaction, and therefore, the spot exchange rate to be used when reporting foreign currency transactions in situations where payment is made or received in advance.
- The new guidance would be applied not only to revenue transactions, but to the initial recognition of other foreign currency transactions where payment is made or received in advance.
- Entities would have the option of applying the proposals either retrospectively or prospectively on initial application.
- The comment period on the proposals ends on 19 January 2016.

Why is the Interpretation being proposed?

The draft Interpretation was developed in response to a request received by the Interpretations Committee to clarify the exchange rate to use when reporting revenue transactions that are denominated in a foreign currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*, in situations where a customer has made a non-refundable payment in advance for goods or services. The Interpretations Committee observed that there is currently diversity in practice between recognising revenue using the spot exchange rate at the date of the receipt of the non-refundable advance payment and the spot exchange rate at the date of the transfer of goods or services, and accordingly, decided to develop an Interpretation of IAS 21.

What are the changes proposed by the draft Interpretation?

The draft Interpretation proposes guidance on identifying the date of the transaction for the purpose of determining the spot exchange rate to be used to translate the asset, expense or income (or part of it) on initial recognition that relates to, and is recognised on the derecognition of, a non-monetary prepayment asset or a non-monetary deferred income liability.

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The draft Interpretation proposes to clarify that the transaction date for this purpose is the earlier of:

- the date that the non-monetary prepayment asset or non-monetary deferred income liability is initially recognised in the entity's financial statements; and
- the date that the related asset, expense or income (or part of it) is recognised in the financial statements (resulting in derecognition of the prepayment or deferred income balance).

For a transaction achieved in stages, a transaction date would be established for each stage.

Observation

For entities with a large volume of foreign currency transactions, application of the draft Interpretation may require adjustment to the software used to calculate the effect of foreign exchange movements.

The draft Interpretation would only cover situations in which the advance consideration denominated or priced in a foreign currency gives rise to the recognition of a prepayment asset or a deferred income liability that is a non-monetary item, and would be applied to both cash and non-cash consideration that is denominated or priced in a foreign currency. The draft Interpretation would not be applied in circumstances where the foreign currency amount of the non-monetary prepayment asset or non-monetary deferred income liability is required to be remeasured subsequently for the purposes of the initial recognition of the related asset, expense or income (or part of it); for example, when the related asset, expense or income is required to be initially recognised at its fair value.

Observation

The IFRS Interpretations Committee decided that the issue is not restricted to revenue transactions, and that the draft Interpretation should also be applied to the initial recognition of other foreign currency transactions similarly affected by the issue. Examples given in the Basis for Conclusions on the draft Interpretation are transactions that include purchases and sales of property, plant and equipment, intangible assets, and investment property; purchases of inventory and services; and also lease contracts as well as some government grants.

Further, entities would not be required to apply the draft Interpretation in respect of insurance contracts and income taxes.

When would the draft Interpretation apply?

The draft Interpretation does not specify an effective date. However, if finalised, earlier adoption is proposed to be permitted.

On initial application, entities would have the option of applying the proposals in the draft Interpretation either retrospectively or prospectively.

The comment period ends on 19 January 2016, and the Interpretations Committee will determine the effective date after considering the comments received on the draft Interpretation.

Key contacts

Global IFRS Leader
Veronica Poole
ifrsglobalofficeuk@deloitte.co.uk

IFRS centres of excellence

Americas

<i>Canada</i>	Karen Higgins	ifrs@deloitte.ca
<i>LATCO</i>	Claudio Giaimo	ifrs-LATCO@deloitte.com
<i>United States</i>	Robert Uhl	iasplus-us@deloitte.com

Asia-Pacific

<i>Australia</i>	Anna Crawford	ifrs@deloitte.com.au
<i>China</i>	Stephen Taylor	ifrs@deloitte.com.cn
<i>Japan</i>	Shinya Iwasaki	ifrs@tohatsu.co.jp
<i>Singapore</i>	Shariq Barmaky	ifrs-sg@deloitte.com

Europe-Africa

<i>Belgium</i>	Thomas Carlier	ifrs-belgium@deloitte.com
<i>Denmark</i>	Jan Peter Larsen	ifrs@deloitte.dk
<i>France</i>	Laurence Rivat	ifrs@deloitte.fr
<i>Germany</i>	Jens Berger	ifrs@deloitte.de
<i>Italy</i>	Massimiliano Semprini	ifrs-it@deloitte.it
<i>Luxembourg</i>	Eddy Termaten	ifrs@deloitte.lu
<i>Netherlands</i>	Ralph Ter Hoeven	ifrs@deloitte.nl
<i>Russia</i>	Michael Raikhman	ifrs@deloitte.ru
<i>South Africa</i>	Nita Ranchod	ifrs@deloitte.co.za
<i>Spain</i>	Cleber Custodio	ifrs@deloitte.es
<i>United Kingdom</i>	Elizabeth Chrispin	deloitteifrs@deloitte.co.uk

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