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Mastering Foreign Currency Accounting: A Pedagogical Case Based on IAS 21

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Abstract. This educational exercise offers a comprehensive application aimed at improving understanding of the implications of fluctuations in foreign currency rates. Grounded in International Accounting Standard (IAS) 21 - The Effects of Changes in Foreign Exchange Rates, the case employs a structured two-step approach: firstly, elucidating the reporting of foreign currency transactions within the functional currency, and secondly, illustrating the conversion of financial statements into a presentation currency distinct from the functional currency. This scenario mirrors real-world business scenarios, containing both isolated and combined forms of currency exposure, thereby equipping students with practical accounting skills in navigating the complexities of international finance. With the British pound (GBP) employed as the functional currency, students engage in transactions denominated in US dollars (USD), culminating in the preparation of financial statements at year-end in Euros (EUR) and the functional currency. Emphasising the importance of professional judgment and critical thinking, the case challenges students to analyse nuanced situations where definitive answers are not always evident. Furthermore, it fosters an in-depth understanding of the impact of exchange differences recognised in comprehensive income, particularly those manifesting directly in profit or loss accounts or within various components of shareholders' equity. Designed for postgraduate and executive master's programmes, as well as intermediate and advanced undergraduate courses, this case offers a dynamic learning opportunity that transcends traditional classroom boundaries, empowering students to navigate the intricate landscape of foreign currency accounting with confidence and expertise.

Keywords: currency translation; foreign exchange rate; foreign exchange transactions; instructional exercise; functional currency; presentation currency; translation of financial statements.

Introduction

> "Could you elucidate the rationale for your company to recognize exchange differences in other comprehensive income but omitting them from profit or loss"?

This is the starting point for a case where you, the students, assume you are a successful consultant assisting the CFO of a newly founded multinational company headquartered in a European country. This multinational corporation, named MNC, has hired you since you are one of a group of outstanding individuals with expertise in advanced accounting and control management systems. Understanding the application of "IAS 21 - The Effects of Changes in

Foreign Exchange Rates" (hereafter IAS 21) is the primary learning goal you will pursue in order to address the question above and other similar problems.

Before you respond, take a break and read the instructions below:

- The lecturer will allow you 30 minutes to read the IAS 21 directly from the IFRS Foundation's website (with a password) or any other academic resource.

- After that, return to the case and read the remainder. The case is divided into four sections, with a total of twelve questions numbered sequentially.

Part 1: Scope of IAS 21 and Relevant Definitions

The company MNC was established on January 1, 20x0. It is a United Kingdom-based organisation that imports and exports items to the United States, as well as the parent company of subsidiaries in Germany and Australia. The currency of the principal economic environment in which MNC operates is the British pound (GBP), however all transactions from and to external parties in the United States are valued in US dollars (USD). MNC prepares financial statements in GBP on each reporting date (i.e., fiscal year-end). However, at the end of the current reporting period, the company prepares financial statements in Euros (EUR) to provide information that the executive directors believe will be useful in attracting the attention of prospective investors from all over the world. Create a report based on the following information:

- 1st Requirement: When you were hired for the role, your first task was to answer the following question: "Can you try to explain why a company can have exchange differences recognised in items of comprehensive income, but at the same time not recognise exchange differences in profit or loss"? Discuss the best possible answer, using relevant IAS 21 excerpts to support your answer.

- 2nd Requirement: Your second objective is to analyse the following dialogue:

  - CFO: You are aware that, from the standpoint of MNC, the Euro is a foreign currency.

  - Auditor: The foreign currency is USD.

  - CFO: And the Euro too!

  - Auditor: Isn't the EUR the presentation currency?