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GLOBAL IFRS EXPERTS

IFRIC 22: Foreign Currency Transactions and Advance Consideration

IFRIC 22 clarifies the accounting for transactions that include the receipt or payment of advance consideration in a foreign currency. IFRS Interpretations Committee (IC) observed some diversity in practice regarding the exchange rate used when reporting transactions that are denominated in a foreign currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates* in circumstances in which consideration is received or paid in advance of the recognition of the related asset, expense or income.

IFRIC 22 is effective for annual reporting periods beginning on or after 1 January 2018 and was adopted by the EU on 3 April 2018.

Scope of IFRIC 22

The Interpretation addresses foreign currency transactions when an entity recognizes a non-monetary asset or a non-monetary liability that arises from the prepayment or prepayment received in advance before the entity recognizes the related asset, income or expense recorded. It is not applicable when an entity measures the related asset, income or expense on initial recognition at fair value or fair value of the consideration received or paid at a time other than the initial recognition of the non-monetary asset or non-monetary liability. Furthermore, the interpretation is not to be applied to income taxes, insurance contracts and reinsurance contracts.

Example 1: Single advance payment for the purchase of a single item of PP&E

On March 20X1, Entity A entered into a contract with a supplier to purchase a machine for use in its business. Under the terms of the contract, Entity A pays the supplier a fixed purchase price of FC 1,000 on 1 April 20X1. On 15 May 20X1, Entity A takes delivery of the machine.

Date	Spot exchange rate FC:LC	Entity A's accounting entries
1 April 20X1	1:1.5	Dr. Prepayment LC1,500 Cr. Bank LC1,500
Entity A initially recognizes a non-monetary asset translating FC1,000 into its functional currency at the spot exchange rate on 1 April 201X. A does not update the translated amount of the non-monetary asset.		
15 May 20X1	1:1.7	Dr. PP&E LC1,500 Cr. Prepayment LC1,500
On 15 May 20X1, Entity A takes delivery of the machine. Entity A derecognizes the non-monetary asset and recognizes the machine as PP&E. On initial recognition of the machine, Entity A recognizes the cost of the machine using the exchange rate at the date of the transaction, which is 1 April 20X1 (i.e. the date of initial recognition of the non-monetary asset).		

Example 2: Multiple receipts of revenue recognized at multiple points in time

On 1 January 20X4, Entity D enters into a contract to sell two products to a customer. Entity D transfers one product on 1 March 20X4 and the second on 1 June 20X4. As required by the contract, the customer pays a fixed purchase price of FC1,000. In applying IFRS 15 Entity D allocates FC 450 of the transaction price to the first product and FC 550 to the second product. FC200 is due and received in advance on 31 January 20X4. Entity D has determined that these FC 200 relate to the first product transferred on 1 March 20X4. The remaining consideration of FC 800 is due and received on 1 June 20X4. On transfer of the first product, Entity D has an unconditional right to FC 250 of the remaining consideration.

Date	Spot exchange rate FC:LC	Entity A's accounting entries
31 January 20X4	1:1.5	Dr. Cash (FC200) LC300 Cr. Contract liability (FC200) LC300
The advance payment is recorded at functional currency using exchange rate at 31 January 20X4. Entity D does not update the translated amount of the non-monetary contract liability (IAS 21.23b).		
1 March 20X4	1:1.7	Dr. Contract liability (FC200) LC300 Dr. Receivable (FC250) LC425 Cr. Revenue (FC450) LC725
Entity D transfers the first product with a transaction price of FC450 on 1 March 20X4. Entity D derecognises the contract liability and recognizes revenue of LC300. Entity D recognises the remaining revenue of FC250 relating to the first product and a corresponding receivable both at the spot exchange rate as of the date that it recognizes the remaining revenue of FC 250, i.e. 1 March 20X4.		
1 June 20X4	1:1.9	Dr. Receivable LC50 Cr. Foreign exchange gain LC50 Dr. Cash (FC800) LC1,520 Cr. Receivable (FC250) LC475 Cr. Revenue (FC550) LC1,045
As the receivable of FC250 is a monetary item, Entity D updates the translated amount until the receivable is settled (1 June 20X4: 250 x 1.9 – 250 x 1.7 = 50). Entity D transfers the second product with a transaction price of FC550 on 1 June 20X4. Entity D recognises revenue of FC550 using the exchange rate at the date of the transaction (1 June 20X4).		

Conclusion

IFRIC 22 will has an impact on all entities that enter into foreign currency transactions for which consideration is paid or received in advance. Applying the interpretation can be challenging for entities that enter into long-term foreign currency contracts with complex payment schedules and/or significant upfront payments.

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