

HK(IFRIC) Interpretation 22 – *Foreign Currency Transactions and Advance Consideration*

Newsletter – Issue No. 4/2017

Background

The International Financial Reporting Standards Interpretations Committee (the “Interpretations Committee”) initially received a question asking how to determine ‘the date of the transaction’ applying paragraphs 21–22 of International Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (“IAS 21”) when recognising revenue. The question addressed a circumstance in which an entity receives advance consideration in a foreign currency. IAS 21 does not specifically address such a circumstance. Accordingly, the Interpretations Committee issued IFRIC Interpretation 22 – *Foreign Currency Transactions and Advance Consideration* (“IFRIC Int-22”).

The Council of the Hong Kong Institute of Certified Public Accountants (the “HKICPA”) considered and agreed with the Interpretations Committee’s basis for conclusions on IFRIC Int-22. Hence, HK(IFRIC) Interpretation 22 *Foreign Currency Transactions and Advance Consideration* (the “Interpretation”) was issued in June 2017 by the HKICPA.

Scope

This Interpretation applies to a foreign currency transaction (or part of it) when an entity recognises a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration before the entity recognises the related asset, expense or income (or part of it).

It does not apply when an entity measures the related asset, expense or income on initial recognition:

- (a) at fair value; or
- (b) at the fair value of the consideration paid or received at a date other than the date of initial recognition of the non-monetary asset or non-monetary liability arising from advance consideration (for example, the measurement of goodwill applying HKFRS 3 *Business Combination*).

An entity is not required to apply this Interpretation to:

- (a) income taxes; or
- (b) insurance contracts (including reinsurance contracts) that it issues or reinsurance contracts that it holds.

Issue

This Interpretation addresses how to determine the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) on the derecognition of a non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration in a foreign currency. The application of this Interpretation is NOT restricted to revenue transactions.

Conclusions

Applying paragraphs 21–22 of Hong Kong Accounting Standard (“HKAS”) 21 *The Effects of Changes in Foreign Exchange Rates*, the date of the transaction for the purpose of determining the exchange rate to use on initial recognition of the related asset, expense or income (or part of it) is the date on which an entity initially recognises the non-monetary asset or non-monetary liability arising from the payment or receipt of advance consideration.

If there are multiple payments or receipts in advance, the entity shall determine a date of the transaction for each payment or receipt of advance consideration.

Effective date

An entity shall apply this interpretation for annual reporting periods beginning on or after 1 January 2018. Earlier application is permitted.

Examples

Example 1: A single advance payment for the purchase of a single item of property, plant and equipment

On 1 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 FC1,000 on 1 April 20X1. On 15 May 20X1, Entity A takes delivery of the machine.

Date	Spot exchange rate FC:LC	Entity A makes accounting entry	
1 April 20X1	1:1.5	Dr. Prepayment LC1,500	
		Cr. Bank	LC1,500
Entity A initially recognises a non-monetary asset translating FC1,000 into its functional currency at the spot exchange rate.			
15 May 20X1	1:1.7	Dr. Machine LC1,500	
		Cr. Prepayment	LC1,500
On 15 May 20X1, Entity A takes delivery of the machine. Entity A derecognises the non-monetary asset and recognises the machine as property, plant and equipment. On initial recognition of the machine, Entity A recognises the cost of the machine using the exchange rate at the date of the transaction, which is 1 April 20X1 (the date of initial recognition of the non-monetary asset).			

Example 2: Multiple receipts for revenue recognised 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 (i.e. FC450 for first product, FC550 for second product), of which FC200 is due and received in advance on 31 January 20X4 related to the first product transferred on 1 March 20X4 and the balance is due and received on 1 June 20X4.

Date	Spot exchange rate FC:LC	Entity D makes accounting entry
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.		
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 recognises revenue of LC300. Entity D recognises the remaining revenue of FC250 relating to the first product at the spot exchange rate and a corresponding receivable.		
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
The receivable of FC250 for the first product is a monetary item. Entity D updates the translated amount of the receivable until the receivable is settled (1 June 20X4) ($250 \times 1.9 - 250 \times 1.7 = 50$). 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).		

Contact us

HONG KONG

43/F., Lee Garden One,
33 Hysan Avenue,
Causeway Bay, Hong Kong
Tel: (852) 3583 3800
Fax: (852) 3583 8001
Email: info@shinewing.hk
Website: www.shinewing.hk

CHENGDU

8/F, Block B, Avic Int Financial Centre,
No.88, High-tech district, Chengdu, Sichuan,
PRC (Postal Code: 610051)
Tel: (86) 28 6299 1888
Fax: (86) 28 6292 2666

TIANJIN

21/F, Xinda Plaza, No.188, Jiefang Road,
Heping District, Tianjin, PRC
(Postal Code: 300042)
Tel: (86) 22 5829 6288
Fax: (86) 22 5829 6299

CHANGCHUN

7/F, Building 7, Wanhao International Business
Plaza, No.9399, People Street, Changchun,
Jilin, PRC (Postal Code: 130022)
Tel: (86) 431 8133 2000
Fax: (86) 431 8133 2111

DALIAN

15/F, Block B, Karen International Mansion,
No.1-1 Section A Wucai Town,
Dalian Development Area, Liaoning,
PRC (Postal Code: 116600)
Tel: (86) 0411 8762 6818
Fax: (86) 0411 8762 6307

FUZHOU

13/F, Block A, Hongli Mansion, No.168,
Hudong Road, Fuzhou, 350003,
PRC (Postal Code: 350003)
Tel: (86) 0591 2830 9955
Fax: (86) 0591 2830 9000

WUHAN

Room 2701-2709, 27/F, Block 4, Xingguang
Wuxian Building (Guanggu Yinzu), No.727
Luoyu Road, Donghu New Technology
Development Zone, Wuhan, Hubei, PRC
(Postal Code: 430071)
Tel: (86) 027 5975 9900
Fax: (86) 027 5975 9922

CHONGQING

26/F, Qibo Building, No.99 Jinyu Avenue,
Northern New District, Chongqing, PRC
(Postal Code: 401122)
Tel: (86) 23 8911 2588
Fax: (86) 23 8911 2599

MELBOURNE

Level 10, 530 Collins Street, Melbourne,
Victoria 3000, Australia
Tel: (61) 3 8635 1800
Fax: (61) 3 8102 3400

BEIJING

9/F, Block A, Fu Hua Mansion
No.8 Chaoyang Men Beidajie,
Dongcheng District, Beijing,
PRC (Postal Code: 100027)
Tel: (86) 10 6554 2288
Fax: (86) 10 6554 7190

SHANGHAI

32/F, China Development Bank Tower,
No.500, Pudong South Road, Pudong New Area,
Shanghai, PRC (Postal Code: 200120)
Tel: (86) 21 6164 3939
Fax: (86) 21 6164 3900

QINGDAO

27/F, HuaYin Mansion, No.5,
Donghai Road(west), Shinan District, Qingdao,
PRC (Postal Code: 266071)
Tel: (86) 532 8089 5858
Fax: (86) 532 8089 5959

YINCHUAN

11/F, Investment Plaza, No.65,
Hubin Street(west), Xingqing District,
Yinchuan, Nixia, PRC (Postal Code: 750001)
Tel: (86) 951 671 8800
Fax: (86) 951 672 1553

KUNMING

9-10/F, Ruyi Plaza, No.36, Middle People Road,
Kunming, Yunnan, PRC
(Postal Code: 650021)
Tel: (86) 871 6815 9955
Fax: (86) 871 6364 6916

NANJING

7/F, Hetai International Mansions, No. 128,
Shanxi Road, Nanjing, Jiangsu, PRC
(Postal Code: 210009)
Tel: (86) 025 5280 8866
Fax: (86) 025 8371 6000

HANGZHOU

Room 702, Wangjiang Internatioal Center,
Shangcheng District, Hangzhou, Zhejiang, PRC
(Postal Code: 310008)
Tel: (86) 0571 2689 7676
Fax: (86) 0571 2689 7636

NANNING

17/F, Tian Jian Business Building, No.8 Zhong
Tai Road, Nanning, Guangxi, PRC
(Postal Code: 530029)
Tel: (86) 771 5086 363
Fax: (86) 771 5086 880

SYDNEY

Level 8, 167 Macquarie Street,
Sydney, NSW 2000, Australia
Tel: (61) 2 8059 6800
Fax: (61) 2 8059 6899

SHENZHEN

10/F, Block A, United Plaza, Binhe Road,
Futian District, Shenzhen,
PRC (Postal Code: 518033)
Tel: (86) 755 8290 0800
Fax: (86) 755 8290 0815

XI'AN

16/F, Block C, Fortune Center, No.180,
Western section of the second ring road,
Xi'an, PRC (Postal Code: 710075)
Tel: (86) 29 6335 8888
Fax: (86) 29 6335 8899

CHANGSHA

26/F, Block C1, Kai Fu Wanda Plaza, No.598,
Zhongshan Road, Changsha, Hunan, PRC
(Postal Code: 410005)
Tel: (86) 731 8828 5566
Fax: (86) 731 8828 5567

JINAN

6/F Huate Plaza, No.17703 Jingshi Road, Lixia
District, Jinan, PRC (Postal Code: 250012)
Tel: (86) 531 8925 9000
Fax: (86) 531 8925 9099

GUANGZHOU

Floor 39, Guangzhou International Trade Center
Building, No.1 Lin He Road (west), Tianhe
District, Guangzhou, PRC (Postal Code: 510620)
Tel: (86) 020 2830 9500
Fax: (86) 020 2830 9530

URUMQI

22 F, Block 2, Hongrui Hao Ting (Jinjiang
International Hotel) No.802, Anju South Road,
Shuimogou District, Urumqi, Xinjiang, PRC
(Postal Code: 830002)
Tel: (86) 0991 6516 688
Fax: (86) 0991 6787 779

TAIYUAN

Room 1103/1105, Fortune Building, No.98
Southern Inner Ring Street, Taiyuan, Shanxi, PRC
(Postal Code: 030012)
Tel: (86) 0351 7899 187
Fax: (86) 0351 7899 023

HEFEI

12/F, Block B, AHCOF Dong Yi Financial Plaza,
No.169 Funan Road, Luyang District, Hefei,
Anhui, PRC (Postal Code: 230001)
Tel: (86) 551 6492 1166
Fax: (86) 551 6492 1111

BRISBANE

Riverside Centre, Suite 1853, Level 18, 123
Eagle Street, Brisbane, QLD 4000, Australia
Tel: (61) 7 3085 0888

SINGAPORE

238A Thomson Road, #25-07/08
Novena Square Tower A, Singapore
(Postal Code: 307684)
Tel: (65) 6336 5588
Fax: (65) 6336 6708

LAHORE

HM House, 7 Bank Square, Off The
Mall, Lahore
Tel: (92) 42 3723 5084 87
Fax: (92) 42 3723 5083

KARACHI

5th Floor, Karachi Chambers, Hasrat Mohani
Road, Karachi
Tel: (92) 21 32411474, 32412754
Fax: (92) 21 32424835

EGYPT

21 Mahmoud Bassiouny, Talaat Harb
Square, Cairo, Egypt
Tel: (202) 2578 2775
Fax: (202) 2578 2776

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