

The Significance of Adopting Functional Currency Concept in IAS21

Sadako Inoue

University of Marketing and
Distribution of Sciences

In 1993 the International Accounting Standards Committee (IASC) revised International Accounting Standard 21, *the effects of changes in foreign exchange rates*, and adopted the situational approach. In 2001 the International Accounting Standards Board (IASB) reorganized from the IASC undertook a project to improve a number of Standards, including IAS21. In 2003 the IASB also revised IAS21 as a part of the project and adopted the functional currency approach.

The IASB's translation approach to IAS21 changed from situational to functional currency. However, from the perspective of historical changes of foreign currency translation, this change is controversial. These approaches are grouped into the same category because they use both temporal and current rate methods. This paper discusses why the IASB adopted functional currency concept and approach in IAS21.

In the first step of our analysis, we discuss the characteristics and clarify the distinctions of these approaches from a standpoint of the translation concept and

purpose. In the second step, we survey the minutes of the IASB's Standing Interpretations Committee (SIC) meetings and the SIC Interpretations, then examine the reason why the IASB had to revise translation standard after adopting situational approach. In the last step, we present the following results.

Some changes of economic environment, such as the introduction of the Euro, causes measurement and presentation problems in IAS21. The former is due to the appearance of an entity that measures items in a currency other than the presentation of its financial statements. The latter is due to the social needs of the entity preparing its financial statements in freely chosen multiple currencies.

In pre-IAS21, revised in 1993, the term 'reporting currency' was defined as the currency used in presenting the financial statements. This choice was substantially regulated and was considered to be the currency that an enterprise normally uses in the country in which it is domiciled. The economic changes would require the 'reporting currency' to have two roles of

presentation and measurement.

Therefore the IASB would introduce the functional currency in which the entity measures in its financial statements. Adopting it means the division between measurement and presentation currencies ; so that the IASB could deal

with the IAS21's problems by caused the economic changes.

Another matter arising from the new translation approach is IAS21 has two different concepts and purposes together. There is room for reconsidering this matter, to be discussed the future.