

Statement of  
Financial Accounting Standards  
No. 14

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Translated by

TsingZai Wu, Associate Professor  
(National Cheng Kung University)

Yann-Ching Tsai, Professor  
(National Taiwan University)

Financial Accounting Standards Committee

Statement of Financial Accounting Standards No.14

The Effects of Changes in Foreign Exchange Rates

**I Introduction**

- (1) This Statement establishes the accounting standards for foreign currency transactions, and for the translation of financial statements of foreign operations into financial statements denominated in the reporting entity's currency.
- (2) This Statement is not applicable to the translation of financial statements denominated in the reporting entity's currency into foreign currencies.

**II Definitions**

- (3) The definitions of key terms used in this Statement are as follows:
  - (a) *Reporting entity* (domestic enterprise): A reporting entity is the entity which owns one or more foreign operations.
  - (b) *Foreign operation*: A foreign operation is a foreign branch, subsidiary, or foreign investment accounted for using the equity method.
  - (c) *Functional currency*: The functional currency is the major currency used for operating decisions, revenue and expenditure by foreign operations.

- (d) *Exchange rate:* An exchange rate is the rate converting one currency to another.
- (e) *Spot rate:* A spot rate is the exchange rate for a currency to be delivered within one business day.
- (f) *Forward rate:* A forward rate is the exchange rate pre-established by two parties to be applied for a specific future date.
- (g) *Foreign loans:* Foreign loans are loans that have to be repaid in foreign currency.
- (h) *Settlement date:* The settlement date is the date that a receivable is received or debt is paid.
- (i) *Monetary items:* Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency. A contract to receive (or deliver) a variable number of the entity's own equity instruments or a variable amount of assets in which the fair value to be received (or delivered) equals a fixed or determinable number of units of currency is a monetary item.
- (j) *Non-monetary items:* Assets and liabilities which are lack of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency.

### III Explanation

- (4) Foreign operating activities of a domestic enterprise may occur due to one of the following situations:
  - (a) transactions denominated in foreign currency (eg, imports or

exports to be paid in foreign currency, or loans or debt denominated in foreign currency);

- (b) ownership of foreign operations.
- (5) Transactions denominated in foreign currency are usually recorded based on the spot rate as of the transaction date.
- (6) When a foreign currency transaction and its settlement occur in the same accounting period, the difference between the amount paid and the carrying value is recorded as current exchange gains or losses.
- (7) When a foreign currency transaction and its settlement occur in different accounting periods, the difference between the amount of foreign currency monetary items translated at the current rate as of the balance sheet date and the carrying value of them as of the transaction date or of the last balance sheet date should be recognized as an exchange gain or loss of the current period. However, transaction gains or losses from foreign loans of a long-term investment nature between the domestic enterprise and its foreign operations should be recorded as an adjustment to stockholders' equity because it is not going to be settled in the foreseeable future.  
Non-monetary items that are measured at fair value in a foreign currency should be translated using the exchange rates at the date when the fair value was determined. When a gain or loss on a non-monetary item is recognized directly in equity, any exchange component of that gain or loss should be recognized directly in equity. Conversely, when a gain or loss on a non-monetary item is recognized in profit or loss, any exchange component of that gain or loss should be recognized in profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency should be translated using the exchange rate at the date of the transaction.
- (8) Deleted

- (9) Deleted
- (10) Deleted
- (11) Deleted
- (12) When the financial statements of the foreign operation are translated into domestic currency, the foreign currency financial statements should be first remeasured by the functional currency if the foreign currency is not the functional currency. This process will have the same result as if the transaction is recorded in the functional currency from the beginning. The exchange gain or loss from remeasurement should be recognized in the current period because it affects directly the cash flows of the foreign operation.
- (13) When the financial statements of a foreign operation are translated into financial statements denominated in the reporting entity currency, the current rate should be used for translation if the foreign currency is the functional currency. The current rate used for translating assets and liabilities is the exchange rate as at the balance sheet date. The current rate used for income statement accounts is the current spot rate that existed at the date of the revenue or expense transaction. For the convenience of practice, a weighted-average exchange rate can be used for income statement accounts. There is no need to use different exchange rates for each transaction. Gains or losses from the above translation are usually not recognized for the current period and are recorded as adjustments to stockholders' equity because gains or losses are not related to cash flows of the foreign operation, but indirectly related to cash flows of the reporting entity.
- (14) When a foreign entity is operating in a highly inflationary economy, its financial statements cannot be measured using a stable unit, and cannot present fairly the financial position and the results of operations of the entity if translated using the current rate. In such case, the domestic company's currency should be used as the functional currency, and the financial statements of the foreign entity

should be remeasured. A highly inflationary economy is defined as one that has a cumulative inflation rate of approximately 100% or more over a 3-year period.

- (15) The following indicators should be considered in identifying whether a foreign entity's currency is the functional currency:
- (a) *Cash flow*: The effect of foreign currency on the cash flow of the reporting entity is small.
  - (b) *Sales price*: Sales prices of products or services are not affected by the short-term changes in exchange rates.
  - (c) *Sales market*: Products or services are priced in local currency and sold in the local market.
  - (d) *Costs of goods sold*: Inputs of goods and services produced, such as labor and material, are acquired or incurred locally.
  - (e) *Financing*: Financing is secured in local currency.
  - (f) *Inter-company transactions*: Inter-company transactions between the domestic entity and foreign entity are low.

The foreign currency is the functional currency if answers tend to be positive for most of the indicators listed above.

## IV Accounting standards

### Accounting for foreign transactions

- (16) Deleted

- (17) Deleted
- (18) Deleted
- (19) Deleted
- (20) Deleted
- (21) Deleted
- (22) Deleted

*Foreign currency transaction for non-derivatives*

Transaction date

- (23) Exposed assets, liabilities, revenues or expenses resulting from foreign currency transactions for non-derivatives should be recorded at the current spot rate of the transaction date.

Balance sheet date

- (24) Exposed monetary items at the balance sheet date should be adjusted by the current rate as at the balance sheet date. The resulting gain or loss from adjustment should be recognized as current period gains or losses. However, exchange gains or losses from intercompany loans of a long-term nature should be recorded as a translation adjustment under stockholders' equity.  
Non-monetary items that are measured at fair value in a foreign currency should be translated using the exchange rates at the date when the fair value was determined. When a gain or loss on a non-monetary item is recognized directly in equity, any exchange component of that gain or loss should be recognized directly in equity. Conversely, when a gain or loss on a non-monetary item is

recognized in profit or loss, any exchange component of that gain or loss should be recognized in profit or loss. Non-monetary items that are measured in terms of historical cost in a foreign currency should be translated using the exchange rate at the date of the transaction.

Exposed assets or liabilities for the purpose of hedging should follow the principles set out in the Statement of Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*.

Settlement date

- (25) Gains or losses from settlement of exposed assets or liabilities should be recognized as current period gains or losses.

*Foreign currency transaction (or contract) for derivatives*

- (25-1) Foreign currency transactions (or contracts) for derivatives should follow the principles set out in the Statement of Financial Accounting Standards No. 34, *Financial Instruments: Recognition and Measurement*.

**Translation of foreign financial statements**

- (26) Financial statements of a foreign operation must be adjusted to conform with generally accepted accounting principles before they are translated into the reporting currency.
- (27) When the financial statements of a foreign operation are translated into the reporting currency, they should be remeasured into the functional currency first if the foreign currency is not the functional currency. The applicable exchange rate is listed in Table 2. The translation gain or loss is included as a component of net income. The functional currency should be applied consistently after it is identified and cannot be altered unless the economic environment has been changed or evidence indicates that the functional currency has changed. When the functional currency is changed, the financial statements of previous years do not have to be restated.

- (28) After the financial statements of the foreign operations have been prepared in the functional currency or remeasured using the functional currency, they should be translated into the reporting entity currency if the functional currency differs from that of the reporting entity. All assets and liabilities should be translated at the current rate as at the balance sheet date. Stockholders' equity accounts should be translated at the historical rate except for the beginning balance of the retained earnings, which is carried by the translated amount of the last period. Dividends are translated at the spot rate of the declared date. Income statement accounts are translated at the current rate or weighted-average rate of the current period (see Table 2).
- (29) Exchange gains or losses resulting from the translation process as described above should be recorded as *Translation adjustments* which are included as a separate component of stockholders' equity.
- (30) If the foreign subsidiary is operated in a highly inflationary economy, the functional currency of the foreign financial statements should be the reporting entity currency and be remeasured according to Paragraph 27.

## V Disclosure

- (31) The difference resulting from foreign currency transactions or remeasurement of foreign financial statements should be recognized as gains or losses in the current period according to this Statement or should be disclosed as a separate component of the income statement.
- (32) The following translation adjustments resulting from the translation of foreign financial statements should be disclosed in the statement

of changes in stockholders' equity or footnotes to the financial statements:

- (a) beginning and ending balance of the cumulative translation adjustments;
  - (b) translation adjustment from current period;
  - (c) the amounts transferred from cumulative translation adjustments and included in net income of the period.
- (33) Deleted
- (34) Changes in exchange rates after the balance sheet date which significantly affects the unsettled balance of the foreign transaction should be disclosed in the notes to the financial statements and include the rate change and its effect.

## VI Notes

- (35) According to the Statement of Financial Accounting Standards No.8, when a business adopts this Statement for the first time, it should restate prior years' financial statements, and disclose the effect on income before extraordinary items, cumulative effects from accounting changes and effect on earnings per share. If the prior period's financial statements are not restated, income before extraordinary items and income of the prior period should be prepared on a pro forma basis.
- (36) This Statement was issued on December 10, 1988, with the first revision on September 22, 2005.

The first revised provision of this Statement should be effective for financial statements with fiscal years beginning on or after January 1, 2006. Earlier adoption is prohibited.

The provisions of this Statement need not be applied to immaterial items.
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**Table 1: Determination of Foreign Operation's Functional Currency**

		<b>Foreign operation's currency as functional currency</b>	<b>Domestic currency as functional currency</b>
(1)	<b>Cash flow</b>	Cash flows relating to individual assets and liabilities of foreign operations are primarily local currency and do not have immediate impact on cash flows of the reporting entity.	Cash flows relating to individual assets and liabilities have an immediate impact on current period cash flows of the reporting entity and are readily available to the domestic entity.
(2)	<b>Sales Price</b>	Sales prices of products or services of foreign operations are influenced by the local competition and governmental regulations rather than short-term exchange rates.	Sales prices of products or services of the foreign operations are influenced by short-term exchange rates. For example, sales prices are determined by global competition or international prices.
(3)	<b>Sales market</b>	Products or services of the foreign operations have a local active sales market no matter they are sold in the local market or exported.	Products or services of foreign operations are sold primarily in the domestic market, or sales contracts are denominated in domestic currency.
(4)	<b>Costs</b>	Raw materials, labor, and other costs of products or services are acquired from the local	Raw materials, labor, and other costs of products or services are acquired from the

	market.	domestic market.
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Table 1: (Continued)

(5)	<b>Financing</b>	Foreign operations are financed primarily in local currency, and cash flows required by repayment of debt and operations are provided primarily from local operations.	Foreign operations are financed primarily in domestic currency, or cash flows required by operations and repayment of debt are not provided primarily by cash flows from operations and should be supported by the domestic entity. Exceptions include resources paid for expansion of foreign operations and will be recovered from the operations.
(6)	<b>Intercompany transactions</b>	There are relatively few intercompany transactions and the foreign operations are independent of the domestic entity. Foreign operations benefited by domestic operations or affiliated company, (patent or brand names are exception)	1. Intercompany transactions are many and foreign operations are interrelated to domestic entity. 2. Foreign operations are used exclusive for holding investment or, intangible assets, or guarantee debts which may be accomplished by domestic entity or other affiliated companies

Table 2: Exchange Rates for Remeasurement and Translation

		Exchange rate for remeasurement	Exchange rate for translation
Assets	Cash, demand deposit, time deposit	Current	Current
	Marketable securities carried at cost:		
	Equity securities	Historical	Current
	Debt securities	Historical	Current
	Accounts and notes receivable and unearned discounts	Current	Current
	Allowance for doubtful accounts	Current	Current
	Inventories:		
	Carried at cost	Historical	Current
	Carried at lower of cost or market	*	Current
	Prepaid expenses	Historical	Current
	Refundable deposit	Current	Current
	Property, plant, and equipment	Historical	Current
	Accumulated depreciation	Historical	Current
	Cash surrender value of life insurance	Current	Current
Deferred income tax assets	Current	Current	
Patents and trademarks	Historical	Current	
Goodwill	Historical	Current	
Other intangible assets	Historical	Current	
Liabilities	Accounts and notes payable and overdrafts	Current	Current
	Accrued expenses	Current	Current
	Deferred income tax liabilities	Current	Current
	Deferred income	Historical	Current
	Other deferred credits	Historical	Current
	Bonds payable and other long-term debt	Current	Current
Stockholders' Equity	Common stock	Historical	Historical
	Preferred stock carried at issuance price	Historical	Historical
	Other paid-in capital	Historical	Historical
	Retained earnings	Not remeasured	Not translated
Income statement	Cost of goods sold	Historical	Current**

Items Related to Nonmonetary Items:	Depreciation on property, plant, and equipment, and amortization of intangible items	Historical	Current**
	Amortization of deferred income taxes	Current	Current**
	Amortization of deferred charges and credits	Historical	Current**

\* When inventories are not recorded at functional currency and the lower of cost or market is applied, the cost of inventories should be remeasured at the historical rate. Then the historical cost in the functional currency is compared to market in the functional currency.

\*\* For convenience, weighted-average exchange rates can be used.