



Solution 15.2

Component	Foreign currency transactions
Index	Initial recognition
Short title	Translation of interest income

Attention: This guidance is based on the revised standards and interpretations that are mandatory for accounting periods commencing 1 January 2005.

Issue

Foreign currency transactions should be translated using the spot rate at the date of the transaction, but an average rate may be used for practical reasons if the exchange rate does not fluctuate significantly [IAS21.21-22(R.05)].

What rate should management use for the translation of interest income that accrues on a daily basis when there is significant fluctuation in the exchange rate?

Background

An entity acquires a foreign currency (FC)-denominated bond on 1 January 20X1 for FC1,000. The bond has five years to maturity and carries a variable market rate of interest (currently 6%). Interest is accrued on a daily basis for a calendar year. Interest is paid on 31 January in the following calendar year (that is the interest for 20X1 will be paid on 31 January 20X2).

Management classifies the bond as held-to-maturity. The bond is therefore carried at amortised cost¹. Interest income and exchange differences are recognised in profit or loss. The exchange rate at the date of acquisition is FC1: Local Currency (LC) 1.5.

At 31 December 20X1, the foreign currency has appreciated and the exchange rate is FC1: LC2. The average rate for the period is FC1: LC1.75 (based on average rates published by the National Bank, which are daily weighted average rates).

Solution

Management should use the daily weighted average exchange rate published by the National Bank. Interest income accrues evenly throughout the period and the weighted average rate will produce the same result as a daily actual rate calculation.

The use of an un-weighted average rate would not be appropriate because exchange rates fluctuate significantly.

¹ For the purposes of this example there is no discount or premium on purchase of the bond; and no transaction costs. Therefore no amortisation needs to be recognised.



Recognition of interest receivable:

Dr	Held-to-maturity investment	LC105 (FC60 x (1.75))	
Cr	Interest income		LC105

At each balance sheet date, the receivable and the bond are translated using the closing rate [IAS21.23(a)].

Translation of the accrued interest receivable into LC at 31 December 20X1:

Dr	Held-to-maturity investment	LC15 (FC60 x (2-1.75))	
Cr	Exchange gain		LC15

Translation of the bond into LC at 31 December 20X1:

Dr	Bond	LC500 (FC1,000x(2-1.5))	
Cr	Exchange gain		LC500