Entities subject to mandatory audit will soon have the option of replacing their financial statements prepared in accordance with the Accounting Act with IFRS financial statements as the Government has recently adopted resolution no. 1387/2015. (VI. 12.) on the adoption of IFRSs for standalone reporting purposes in Hungary. Furthermore, on 24 September 2015 the Ministry for National Economy published the proposed law changes required for the adoption of IFRSs for standalone reporting purposes in Hungary. As a result, it could be easier for many entities to prepare, for instance, their reports to their parent companies since such entities will no longer be affected by the differences between IFRSs and the Accounting Act. However, reporting due to currency differences will continue to require additional work in cases where the currency of the report to be prepared for the parent company is different from those used in the entity’s financial statements.

IAS 21 deals with the effects of changes in foreign exchange rates. In order to understand what responsibilities entities will have, we must first understand what the standard means by the concepts of functional currency and presentation currency. The functional currency is the currency of the primary economic environment in which the entity operates, i.e. in which it primarily generates and expends cash. The presentation currency is the one in which the entity presents its financial statements.

The standard provides guidance regarding the factors that entities must consider when determining their functional currency. In practice, this means that an entity must be able to determine the currency which mainly influences the sales prices of goods and services, as well as the official currency of the country whose competitive forces and regulations mainly determine the sales prices of the entity’s goods and services. Another factor that must be considered is the currency in which costs (such as labour and material costs) are denominated and settled.

However, if the entity is unable to clearly determine its functional currency based on the above, the entity’s management will select, at its own discretion, the functional currency which best reflects the economic effects of the relevant transactions, events and conditions.

Transactions which are not denominated in the entity’s functional currency must be recorded on initial recognition in the entity’s functional currency by applying the spot exchange rate at the date of the transaction.
If there is a change in the entity’s functional currency, then the entity must apply the translation procedures for the new functional currency prospectively, starting from the date of the change. However, the functional currency can be changed only if there is a change in the underlying transactions, events or conditions. In such cases, the entity translates all items into the new functional currency using the exchange rate at the date of the change.

Under IAS 21, an entity may present its financial statements in any currency. In such cases, the results and financial position of the entity shall be translated into the presentation currency in such a way that assets and liabilities (including comparatives) shall be recalculated at the closing rate at the date of that statement of financial position.

Income and expenses for each item in the income statement shall be translated at exchange rates at the dates of the transactions and all resulting exchange differences shall be recognised separately in equity since such exchange differences have no effect on present and future cash flows from operations. For practical reasons, a rate that approximates the actual exchange rate at the date of the transaction (such as an average weekly or monthly exchange rate) is often used. Such an approach is, however, inappropriate if there are significant fluctuations in exchange rates.

Exchange differences may result from translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences may arise both on income and expense items recognised in profit or loss and on those recognised directly in equity.

Gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity into a different currency may have tax effects. IAS 12 Income Taxes applies to these tax effects.

When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with International Financial Reporting Standards only if they comply with all the requirements of each applicable Standard and Interpretation, including the translation method for exchange differences.

When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency. When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.

When an entity presents its financial statements in a currency that is different from both its functional currency and its presentation currency, the entity shall clearly identify the information as supplementary information to distinguish it from the information that complies with International Financial Reporting Standards, and shall disclose the currency in which the supplementary information is displayed, as well as the method of translation used to determine the supplementary information.
Contact us

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