IFRS 18: Classification of Foreign Exchange Differences

Extract, IFRS® Accounting Standards Discussion Group Report on the Meeting – September 18, 2025

Background

IFRS 18 *Presentation and Disclosure in Financial Statements* is effective for annual reporting periods beginning on or after January 1, 2027, with retroactive application to the comparative period. It requires entities to classify income and expenses into one of five categories in the statement of profit or loss: operating, investing, financing, income taxes and discontinued operations.

Paragraph B65 of IFRS 18 specifies how entities should classify foreign exchange gains and losses on the statement of profit or loss. It says, "an entity shall classify foreign exchange differences included in the statement of profit or loss applying IAS 21 *[The Effects of Changes in Foreign Exchange Rates]* in the same category as the income and expenses from the items that gave rise to the foreign exchange differences, unless doing so would involve undue cost or effort." For example, if an entity classifies income and expenses relating to a receivable in the operating category, it should also classify foreign exchange gains or losses relating to that receivable in the operating category. Similarly, if an entity classifies income and expenses relating to an issued debt instrument in the financing category, it should also classify the foreign exchange gains or losses relating to that debt instrument in the financing category.

Sometimes a transaction can give rise to income and expenses that are classified in more than one category (e.g., in both the financing and operating category). In these cases, paragraph B67 of IFRS 18 requires the entity to use judgment to determine whether the foreign exchange difference relates to the amount classified in the financing or operating category. Entities should not allocate foreign exchange differences arising from a single transaction to multiple categories. For example, all the foreign exchange differences arising from the translation of a lease liability to an entity's functional currency must be classified in a single category in the statement of profit or loss. Entities should assess each foreign exchange difference to determine whether it would involve undue cost or effort to classify it based on principles described above. If such classification would involve undue cost or effort, the foreign exchange gain or loss should be recognized in the operating category.

Fact Pattern 1

- Entity A is based in Canada but has a functional currency of US dollars (USD).
- There is a long-term lease for Entity A's head office, which is denominated in Canadian dollars (CAD). Entity A has recognized a lease liability and a right-of-use (ROU) asset for the head office lease.

- Since the lease liability is a monetary liability, Entity A remeasures it at each balance sheet date using the current exchange rate in accordance with IAS 21.
- Since the ROU asset is a non-monetary asset, Entity A does not remeasure it to its functional currency at the balance sheet date.
- The lease liability arises from a transaction that involves more than the raising of finance, as Entity A receives an ROU asset for the head office building rather than cash, own equity or the extinguishment of a financial liability.

Issue 1: Where should Entity A classify the foreign exchange gains and losses that arise on the translation of the lease liability to Entity A's functional currency in the statement of profit or loss?

Analysis

Classification of income and expenses related to the lease liability and ROU asset

Paragraph 61 of IFRS 18 requires interest income and expenses relating to a lease liability and income and expenses arising from changes in interest rates to be recognized in the financing category. Other changes to the lease liability, such as those that arise from remeasurements or modifications in accordance with IFRS 16 *Leases* should not be recognized directly in the statement of profit or loss. Instead, they should adjust the ROU asset, which impacts profit and loss through amortization.[4] Entities recognize amortization expense in the operating category of the statement of profit or loss.

View 1A – Entity A should recognize the foreign exchange gains and losses in the financing category, consistent with the classification of interest expense on the lease liability.

Paragraph B65 of IFRS 18 requires entities to classify foreign exchange differences included in the statement of profit or loss in the same category as the income and expenses of the item that gave rise to the foreign exchange differences. Interest is the only income and expense item included in the statement of profit or loss related to the lease liability.

Per paragraph 30(b) of IFRS 16, entities should record other remeasurements as adjustments to the ROU asset. These adjustments are not income and expenses. Although they eventually affect profit and loss through amortization, this expense pertains to a non-monetary asset that is not remeasured at the balance sheet date.

Proponents of this view think foreign exchange differences are attributable solely to the lease liability and not to the ROU asset. Since interest is the only item of income and expenses related to the lease liability, and it is categorized as a financing item, proponents of this view think foreign exchange gains and losses arising from translation of the lease liability should also be recognized in the financing category.

View 1B – Entity A could recognize the foreign exchange gains and losses in either the operating or financing category

Proponents of this view note that a lessee translates the present value of lease payments in a foreign-currency denominated lease into its own functional currency at the foreign exchange rate in effect at lease commencement. The lessee recognizes the foreign exchange effects of such translation in the initial recognition of the lease liability and ROU asset. IFRS 16 also requires entities to recognize certain remeasurements of the lease liability in the ROU asset (e.g., lease modifications that do not result in a separate lease or a reduction in the scope of the lease), presumably with the related foreign exchange effects. As a result, the initial recognition of the lease liability and changes in the lease liability impact the entity's income and expenses through amortization of the ROU asset, which is classified in the operating category. In contrast, interest expense on the lease liability is classified in the financing category.

Therefore, they think Entity A recognizes income and expenses related to the lease liability in both the operating and financing category. Under this view, the lease liability and the ROU asset are inseparable, and therefore, the impacts on the statement of profit and loss should be considered together.

When an entity recognizes income and expenses relating to a single item in more than one category on the statement of profit and loss, paragraph B67 of IFRS 18 indicates that entities should apply judgment to determine the appropriate classification of foreign exchange differences. Therefore, proponents of this view think Entity A should assess whether the foreign exchange differences should be presented in the operating or financing category. Entity A should apply judgment based on the facts and circumstances surrounding the transaction.

Under this view, Entity A might recognize the foreign exchange gains and losses in either the operating or financing category, depending on the specific facts and circumstances. Group members who support this view were asked to discuss the facts and circumstances they might consider when making this judgment.

The Group's Discussion

Several Group members supported View 1A as they think the foreign exchange differences arise from the translation of the lease liability only. While they acknowledge that the initial recognition of the lease liability results in the recognition of a ROU asset, and some changes to the lease liability adjust the ROU asset, they still view the lease liability and the ROU asset as separate items. To further support this view, one Group member noted that the ROU asset could be impaired while the lease liability remains on the balance sheet. In this case, the asset would no longer be amortized in the statement of profit and loss, meaning there would be no further operating expense related to it. Some Group members noted that this view results in more consistent and comparable information among entities, which is one of the objectives of IFRS 18.

While many Group members supported View 1A, several noted that they could not preclude View 1B. One Group member noted that paragraph B53(c) lists lease liabilities as an example of a liability that arises from a transaction that does not involve only the raising of finance. They noted that paragraph B67 clearly indicates that an entity might classify income and expenses from such transactions in more than one category. Therefore, the entity would need to apply judgment to determine whether the foreign exchange differences relate to the amount classified in the financing or operating category. They also noted that paragraph BC218 in the Basis for Conclusions explains that foreign exchange differences on a liability payable in a foreign currency might be viewed as arising from the entity's financing decisions (classified in the financing category) or the entity's purchasing decisions (classified in the operating category). They also noted that paragraph BC219 further emphasizes the need to apply judgment to determine the classification of foreign exchange differences. Some Group members who support View 1B think in most cases entities would still end up classifying the foreign exchange differences in the financing category as it could be challenging to support a view that they relate to the ROU asset.

Fact Pattern 2

- Parent P presents its consolidated financial statements in CAD, which is its functional currency.
- Parent P owns a wholly owned subsidiary (Subsidiary S), whose functional currency is USD.
- Parent P has advanced amounts to Subsidiary S through a demand loan arrangement, denominated in USD. The loan is *not* considered to represent part of Parent P's net investment in Subsidiary S under paragraph 32 of IAS 21.
- While the loan arrangement is eliminated upon consolidation, Parent P recognizes the exchange gains and losses that arise from translating the loan to CAD in accordance with paragraph 45 of IAS 21.

Issue 2: Where should entities recognize foreign exchange gains or losses arising from intercompany loans (that do not form part of the net investment of the parent) in the statement of profit and loss under IFRS 18?

Analysis

Paragraph B65 of IFRS 18 requires entities to classify foreign exchange differences included in the statement of profit or loss in the same category as the income and expenses from the items that gave rise to the foreign exchange differences. However, interest income and expenses, and gains and losses on extinguishment of intercompany loans, are eliminated upon consolidation.

A similar issue has been submitted to the IFRS Interpretations Committee (the Interpretations Committee). The Interpretations Committee discussed this submission at its September 2025 meeting after this IFRS Accounting Standards Discussion Group's agenda paper was prepared. At that meeting, the Interpretations Committee concluded that two of the views in this agenda paper are not permissible (View 2B and View 2C). The Interpretations Committee ultimately reached consensus to issue a tentative Agenda Decision that indicates that it did not come to a majority view between two views (that are similar to View 2A and View 2D in this agenda paper) and further tentatively agreed that they would not recommend the matter to the International Accounting Standards Board for standard-setting.

While all four views were presented to the Group, Group members only discussed the merits of View 2A and View 2D as the Interpretations Committee already indicated that View 2B and View 2C are not permissible. At the time of the Group's discussion and the preparation of the meeting report, the Interpretation Committee's decisions were tentative and still subject to public consultation. On September 26, 2025, following the Interpretations Committee meeting, the Interpretations Committee issued its tentative agenda decision on this matter which outlines the views presented to the Committee and the outcome of the discussion.

View 2A – The classification depends on the classification of the gains and losses in the separate financial statements of the entity in which the gains and losses arise by applying IFRS 18.

The foreign exchange gains and losses arise in Parent P from the translation of a monetary item (loan to Subsidiary S) from USD to CAD. Under this view, Parent P would consider the classification of these gains or losses in the separate financial statements of Parent P. For example, assuming Parent P does not have a main business activity of investing in financial assets such as loans, Parent P would classify the interest income from the loan to Subsidiary S in the investing category. This is because the loan generates a return individually and largely independently of the entity's other resources. The interest income of Parent P is eliminated upon consolidation, but the foreign exchange gains remain in the investing category. Proponents of this view note that this is consistent with the principles in IFRS 18 because the foreign exchange arises on an investing activity of the parent that is not eliminated through the consolidation process.

If the intercompany loan was denominated in CAD, then there would be no exchange gains or losses that arise in the separate financial statements of Parent P. However, they would arise in the separate financial statements of Subsidiary S. If the transaction meets the definition in paragraph B50 of IFRS 18 of a "transaction that involves only the raising of finance," Subsidiary S would recognize all the gains and losses, including foreign exchange gains and losses, relating to this loan payable in its financing category under IFRS 18. This classification would therefore be retained upon consolidation.

View 2B – The foreign exchange gains and losses should be recognized in the financing category because the nature of the arrangement is primarily related to intergroup financing.

Proponents of this view note that the purpose of the underlying transaction is to provide financing between Parent P and Subsidiary S. Since the purpose of the intercompany loan is only to provide financing to the subsidiary (even though the loan is eliminated upon consolidation), the foreign exchange gains or losses should be recorded in the financing category. This view differs from View 2A because it looks to the nature of the transaction from a consolidated group level, rather than from the perspective of the issuer or recipient of the financing in separate financial statements. As noted earlier, the Interpretations Committee reached a consensus that this view does not have technical merit.

View 2C – The foreign exchange gains and losses follow the classification of other gains and losses relating to cash and cash equivalents in the consolidated financial statements.

Proponents of this view note that the foreign exchange gains and losses arise from the movement of cash and cash equivalents around the group. They note that while the loan is eliminated upon consolidation, the foreign exchange gains and losses are not eliminated because they represent a commitment to convert one currency into another and expose the reporting entity to a gain or loss through currency fluctuations.

Since these foreign exchange gains and losses arise fundamentally from movements in cash balances between group entities, proponents of this view think they should be recognized in the same category as other income and expenses related to cash and cash equivalents.

This would typically place them in the investing category. However, if Parent P manages financial assets as a main business activity in its consolidated financial statements, the classification would shift to the operating category. As noted above, the Interpretations Committee reached a consensus that this view does not have technical merit.

View 2D – The foreign exchange gains or losses are recognized in the operating category, which is the residual category under IFRS 18.

Proponents of this view think the general principle in paragraph B65 of IFRS 18 does not apply to this fact pattern because there are no other items of income and expenses on the consolidated financial statements that relate to the item giving rise to the foreign exchange gain or loss. Therefore, they think it should be classified in the operating category, which is the residual category under IFRS 18.

Proponents of this view think the presentation of income and expenses in the separate financial statements of the parent or the subsidiary is irrelevant to this assessment because the consolidated financial statements represent a distinct reporting entity. They also note that in other aspects of applying IFRS 18, such as the determination of whether there are specified main business activities, the determination must be made at the level of the reporting entity (paragraph B37 of IFRS 18). They think this reinforces that the presentation and disclosure requirements of IFRS 18 are intended to be applied from the perspective of the consolidated entity. They think presentation determinations made in the separate financial statements are not relevant because they are different from the consolidated reporting entity.

Supporters of View 2D may also refer to the "undue cost and effort" clause in paragraph B65 of IFRS 18. They suggest that since there are no other gains and losses recognized for the intercompany loan, undue cost and effort is required to determine where foreign exchange gains and losses should be classified. This undue cost and effort would also result in classification of foreign exchange gains and losses in the operating category.

The Group's Discussion

Several Group members supported View 2D as they think that the assessment of the category of foreign exchange gains and losses should be done at the consolidated reporting entity level. They note that the intercompany loan is eliminated on consolidation, and therefore, there are no items of income and expense on the consolidated financial statements related to the item giving rise to the foreign exchange gains or losses. Therefore, the entity would classify foreign exchange gains or losses on intercompany loans in the operating category, which is the residual category.

While some Group members think View 2A has merit, they also noted that it could be challenging to apply. The fact pattern in this meeting report is relatively simple. However, some Group members noted that many entities have more complicated intercompany loan structures. They think in such situations it can be onerous to assess the category of income and expense related to each intercompany financing transaction. Therefore, an entity might apply the “undue cost and effort” clause in paragraph B65 of IFRS 18 and classify the foreign exchange gains and losses in the operating category.

The Group noted that other types of foreign currency transactions exist in practice that may also require an entity to apply judgment. Therefore, it encouraged entities to begin their analysis of their foreign currency transactions as soon as possible to determine their classification under IFRS 18.

The Group also encouraged the AcSB and other Canadians to respond to the Interpretations Committee’s tentative Agenda Decision on the Classification of a Foreign Exchange Difference from an Intragroup Monetary Liability (or Asset). This will ensure Canadian perspectives are considered as the tentative agenda decision flows through the Interpretations Committee’s process.