Scuola Dottorale Internazionale

Diritto ed Economia "Tullio Ascarelli"

Sezione di Economia Aziendale

- XXVII ciclo -

FOREIGN CURRENCY MATTERS

The effects of the IAS/IFRS adoption on the Italian entities' functional currency and on foreign currency translation

Supervisor:
Professor Simona Arduini

PhD Student:
Eliana Marsico

Anno Accademico 2015/2016

TABLE OF CONTENTS

CHAPTER ONE

THE DEFINITION AND MEASUREMENT OF FOREIGN CURRENCY TRANSACTIONS: AN ANALYSIS OF EXISTING ACCOUNTING MODELS

CHAPTER TWO

THE FUNCTIONAL CURRENCY CONCEPT AND THE FOREIGN CURRENCY TRANSACTIONS UNDER THE INTERNATIONAL ACCOUNTING STANDARDS

CHAPTER THREE

THE FUNCTIONAL CURRENCY CHOICE AND ITS EFFECTS ON THE ACCOUNTING AND FINANCIAL REPORTING OF ITALIAN COMPANIES: AN EMPIRICAL CASE

ABSTRACT

This thesis investigates the effects of the International Accounting Standard 21 (IAS 21) governing the translation of foreign currency transactions and foreign currency financial statements on the financial performance of Italian companies.

The main purpose of this study is to assess the impacts that the functional currency approach required by IAS 21 may have on the quality of financial reporting of Italian companies, exploring the extent to which the functional currency designation affects the choice of translation method and the recognition of exchange gains and losses in financial statements.

There is a massive foreign currency translation literature, but virtually no empirical research exists that tests the impacts on financial statements of the functional currency choice under IAS 21. This work, to the best knowledge of the author, is one of the first studies – and likely the first in its kind – that examines the IAS/IFRS requirements on foreign currency issues and studies the extent of disclosure and compliance with IAS 21 requirements in annual reports for Italian companies.

This research stems from the fact that a rigorous adherence to the functional currency criteria ruled by IAS 21 provides a different picture of companies' performance if compared to those cases in which those criteria are ignored (as is the case under Italian GAAP).

This study approaches the subject from a local company perspective and focuses on the Italian experience through the study of an actual case.

The findings of this thesis show that there could be significant impacts in the performance earnings when the functional currency criteria are applied by Italian companies. Hence, this work supports the approach adopted by IAS/IFRS – and converging with US GAAP – that led to the introduction, at international level, of the functional currency concept to achieve high quality financial reporting, transparency and international comparability.

ABBREVIATIONS

The following table provides a list of of the technical references and definitions for the abbreviations and acronyms used within this thesis.

ASC 830	Accounting Standard Codification Topic 830, *Foreign Currency Matters*
BS	Balance Sheet
EUR	Euro
FAS 52	Statement of Financial Accounting Standards 52, *Foreign Currency Translation*
GAAP	Generally Accepted Accounting Principles
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IASCF	International Accounting Standards Committee Foundations
IFRIC	International Financial Reporting Interpretations Committee
IFRS	International Financial Reporting Standards
ITC	Italian Income Tax Consolidated Code
OCI	Other Comprehensive Income
P&L	Profit and Loss Account
SFAS	Statement of Financial Accounting Standards
SIC	Standing Interpretations Committee (IASC)
USD	United States Dollar

INTRODUCTION

In an increasingly international economy, foreign currency translation represents a crucial issue for financial statements to afford their readers an aggregate view of global operations denominated in several different currencies. If most investors had stayed within national boundaries (as was the case until the 1970s), the currency translation would have remained unproblematic. When business become international, the floating of foreign exchange rates complicates the financial management of multinational business.

The aim of this thesis is to establish the effect of exchange rates movements on the financial performance of Italian companies engaged in international activities.

When accounting for foreign currency transactions, major troublesome areas are the identification of the appropriate translation method that can be used for both domestic and consolidated financial reporting purposes and the related treatments of foreign exchange gains and losses. These issues, combined with variable rates of exchange, make it difficult to compare financial results from one company to another, or in the same company from one period to the next.

To achieve reporting uniformity, the International Accounting Standards Board (IASB) – the body in charge of setting international accounting standards IAS/IFRS – released International Accounting Standard 21 - The effects of changes in foreign exchange rates (IAS 21). In providing an international guidance on the translation of foreign currency transactions and foreign currency financial statements, IAS 21 seeks to provide information that is generally compatible with the expected economic effects of an exchange rate change on an enterprise's cash flows and equity. This goal is based on the concept of a functional currency, that is the currency of the primary economic environment in which the entity operates and generates cash flows.

This thesis explores the functional currency approach required by IAS 21 and investigates the extent to which the functional currency designation affects the choice of translation method and the recognition of exchange gains and losses in financial statements. In doing so, this research approaches the subject from a local company perspective and focuses on the Italian experience through the study of an empirical case.

The main purpose of this study is to assess the impacts that the functional currency approach provided by IAS 21 may have on the quality of financial reporting of Italian companies, in order to evaluate whether financial information reflects the real-world economic phenomena that IAS/IFRS purport to represent.

On the one hand, this thesis attempts to contribute to the extant debate about the selection of foreign currency translation method (temporal method of translation versus the current rate method) and the related impacts on the reporting earnings, approaching the subject from the perspective that such selection is a function of the functional currency choice. On the other hand, this work, to the best knowledge of the author, is one of the first studies – and likely the first in its kind – that examines the IAS/IFRS requirements on foreign currency issues and studies the extent of disclosure and compliance with IAS 21 requirements in annual reports for Italian companies.

The findings of this thesis show that a rigorous adherence to the functional currency criteria ruled by IAS 21 may provide a different picture of companies' performance if compared to those cases in which those criteria are ignored (as is the case under Italian GAAP). Hence, this work supports the approach adopted by IAS/IFRS – and converging with US GAAP – that led to the introduction, at international level, of the functional currency concept to achieve high quality financial reporting, transparency and international comparability.

The thesis is divided into three parts. Based on the extant literature, Chapter One deals with the financial accounting aspects of foreign currency translation, providing a summary of the various cases where foreign currency translation is required and the related various translation methodologies. Chapter Two discusses, broadly and comparative, the foreign currency translation approach required by IAS 21, providing evidence of the significant role played by the concept of a functional currency and its identification criteria in financial performance, as set forth by IAS 21. Then, Chapter Three illustrates the selected case study, providing evidence helpful to inform the debate and the decision-making process about the reporting and tax implications on Italian companies of the functional currency approach required by IAS 21.

CHAPTER ONE

THE DEFINITION AND MEASUREMENT OF FOREIGN CURRENCY TRANSACTIONS: AN ANALYSIS OF EXISTING ACCOUNTING MODELS

Summary: 1. Introduction. Language and terminology. - 2. The importance of foreign exchange issues affecting national and multinationals enterprises: background of this study. - 3. Foreign currency transactions and remeasurement: from the translation of transactions to the translation of financial statements. - 4. Functional currency and translation of foreign currency transactions. - 5. Translation of financial statements of a foreign entity for consolidated reporting. - 6. Translation of foreign branches' accounts - 7. The multicurrency accounting: rules and practices of multinational companies. - 7.1 The multicurrency accounting versus the functional currency accounting - 8. Translation and the use of language as a means of communication in accounting. - 9. Foreign currency translations in the Italian tax legislation: some highlights.

1. Introduction. Language and terminology.

During last few decades, a rapid internationalization of business has occurred. Undoubtedly, we are now living in a world where all the major economic functions – consumption, production, and investment – are highly globalized. The today's globalized and integrated world economy has lead market operators and consumers to be routinely involved in sales and purchases that are expressed in several different currencies.

When different national currencies are exchanged for each other, there is a definite need to remeasure the currency serving as the medium of exchange in transactions into the national currency of each operator. The most important reason for this is the need for international operators to have their accounts and financial statements expressed in one single currency, the latter representing the currency unit in which their income and financial position are measured. Since this issue affects operators from different countries, languages and accounting cultures, linguistic implications and terminology for accounting need to be considered.

The process of remeasuring accounting data from a currency to another is defined as *translation*. This word has a special technical meaning in accounting since it identifies the process whereby the financial data expressed in terms of one currency are restated in terms of another. If, for example, an Italian company, which prepares its financial statements in Euro, purchases an asset from an American supplier for the amount of 5,000 USD, this asset needs to be included in the company's balance sheet and therefore, it must be "remeasured" in terms of Euro currency. If the current exchange rate is 1 EUR = 1.3 USD, the corresponding EUR value of 5,000 USD would be 3,846.15 EUR (i.e., 5,000 USD × 1 EUR/1.3 USD), so that the asset '5,000 USD' can be included in the balance sheet at the value of 3,846.15 EUR. Under the accountant's terminology, this process is deemed to be the *translation* of the asset value from USD to EUR and this term is that commonly adopted by International Financial Reporting Standards (IFRS)[1] to mean that the basis for measurement is changed from a currency to another.

In several accounting languages (such as Italian and French languages), the term *translation* is commonly intended to have the same meaning as the term *conversion*, even though a conceptual distinction exists. In fact, notwithstanding the above terms appear to be similar in their meaning, *translation* represents the accounting procedure aimed at restating in the reporting currency of the enterprise those amounts that are denominated or measured in a different currency, while *conversion* implies a physical exchange of one currency for another[2].

In the present work, in order to avoid misunderstandings inherent in the use of terms, the words *translation* and *conversion* are used as synonyms.

---

[1] The term "International Financial Reporting Standards" includes IFRS, IFRIC Interpretation, IAS and SIC Interpretations (IASCF, 2003).

[2] ANDREI P., *Il bilancio consolidato nei gruppi internazionali. Metodologie di traduzione dei bilanci espressi in moneta non di conto*, Giuffrè, Milano, 1994, p. 88.

A further issue which arises in accounting terminology – and may cause confusion – is that international accounting standards contain concepts that may not form part of one country accounting culture. This is the case of the *functional currency* concept ("valuta funzionale", in the Italian language version of the IFRS) that under both IFRS and US GAAP is defined as the currency of the primary economic environment in which the entity operates – that is normally the currency of the environment in which an entity primarily generates and expends cash.

An exact equivalent of this concept does not exist in the Italian accounting terminology and regulations. The (perceived) nearest equivalent in translation, that is available in Italian language, is the term "*moneta di conto*" (a literal English translation may be "book" money[3]) that refers to the currency commonly used in a certain country to account for business transactions and operations[4] (hereafter termed "home currency"). Any currency other than the functional currency (for IFRS adopters) or home currency (for Italian GAAP) is termed as *foreign currency*.

Even though significant differences exist in the concepts of functional currency and home currency[5], for the purposes of this chapter, these terms are treated as having the same meaning, namely it is referred to as the currency adopted by enterprises for the recording of business transactions in their books and accounts and in their separate financial statements.

Based on these premises, this chapter examines the financial accounting aspects of foreign currency translation, providing a summary of the various cases and situations where foreign currency translation is required. It illustrates the various methodologies applicable to translate foreign currency amounts in

---

[3] Source: http://ec.europa.eu/economy_finance/euro/adoption/euro_area/index_en.htm.
[4] See Art. 1 ("Definitions") of Legislative Decree no. 213 of 24 June 1998 that governs the introduction of the Euro in Italy.
[5] A specific analysis on this conceptual difference and its implications is dealt with in Chapter Two.

accounting, also covering the relevant literature existing in this field in both the national and international scenario.

2. The importance of foreign exchange issues affecting national and multinationals enterprises: background of this study.

With the internalization of companies' business activities, a significant importance has been given to the currency translation. In today's global economy, many companies that are part of international groups make a sizable amount of their transactions in foreign currencies, having sales, purchases, financing and the like that can be denominated in a dozen of difference currencies.

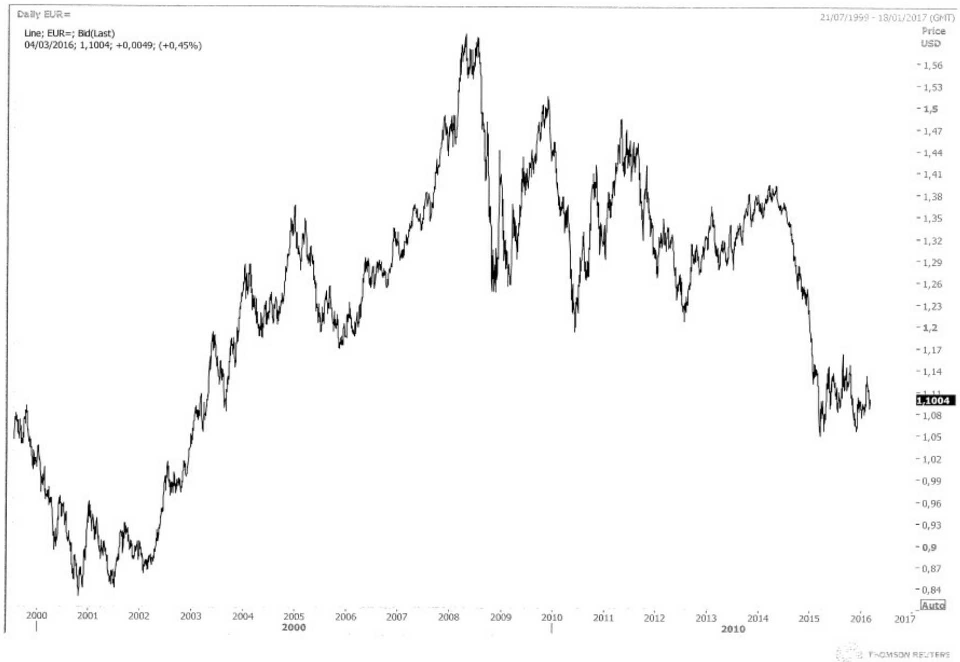
In fact, over the past years, many companies have changed their operating business models, expanded internationally, and often transact business in multiple global currencies. This markets globalization has led to increased complexities for firms with respect to the evaluation and reporting of significant data and amounts of transactions that are denominated in one or more foreign currencies.

Evaluating foreign currency operations is often complex and may require significant judgment for the purpose of defining corporate policies and instruments suited for foreign exchange rate risk management[6]. The main problem with controlling and reporting foreign currency operations is that exchange rates are constantly in flux. As shown in figures 1 and 2 (below), they often change moment by moment.

---

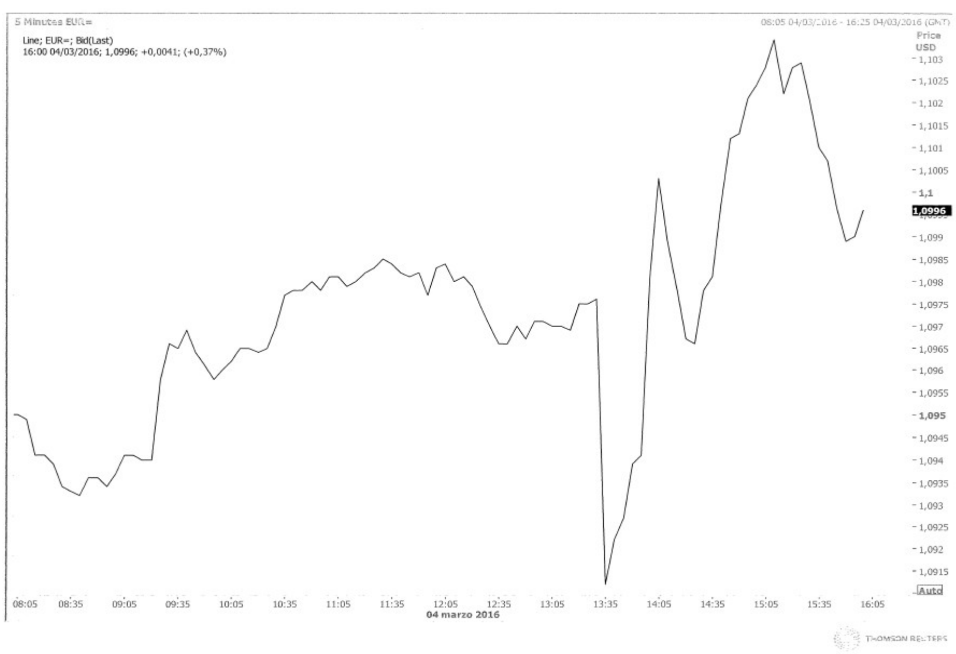
[6] "The analysis of foreign financial data – that represents a preliminary action to properly address corporate policies and management of foreign exchange risks – is indeed a complex activity for the corporate management. Specific issues may arise in relation to the conversion methodologies that, whether not correctly identified, can lead to untrue data and information regarding the status and the perspectives of financial accounts and decisions". See TUTINO F., *Il controllo di gestione dei rischi di cambio nelle imprese e nei gruppi aziendali*, in *Banche e Banchieri*, 1, 1989, p. 23.

Figure 1. Foreign exchange rates EUR/USD from 2000 to March 4, 2016



Source: Reuters Foreign Exchange Rates Program.

Figure 2. Foreign exchange rate EUR/USD on March 4, 2016



Source: Reuters Foreign Exchange Rates Program.

When exchange rates float, the reporting of foreign currency amounts poses a challenge for financial accounting. In theory, companies that are exposed to exchange rate movements should be affected by significant impacts in their cash flow and profitability.

The fact that exchange rates are not fixed creates two problems for the accountant:

1. Identifying the appropriate rate to be used when translating an asset/liability denominated in a foreign currency;
2. Identifying the accounting methodologies to record the gain or loss that arises when exchange rates change[7].

As currency conversion may represent the main problem that international controlling is dealing with at the level of cross-border groups[8], financial managers are frequently required to be involved in exchange rate risk management[9], being the latter an integral part in every firm decisions about foreign currency exposure, for the purpose of securing the firm's profitability.

This need is due to the economic consequences associated with financial information. The corporate financial reporting process produces information which is used by financial stakeholders to monitor the behavior and actions of management and to make investment decisions[10]. In simplest terms, financial accounting plays the role of communicating information, so that all notices and data regarding the economic environment of an organization are provided to

---

[7] NOBES C., PARKER R., *Comparative International Accounting*, Tenth edition, Prentice Hall, New York, 2008, p. 388.

[8] In a survey conducted by Pausenberger and Roth, there have been five issues identified in relation to international controlling: currency conversion; different conditions of the economic environment; different country risks; transfer prices; cultural distance. This empirical study classifies currency conversion as the main problem in the international controlling. See PAUSENBERGER E., ROTH A., *Störfaktoren im internationalen Controlling,* Zeitschrift für betriebswirtschaftliche Forschung, 1997.

[9] D'ALESSIO L., *Le operazioni in moneta estera*, Giappichelli, Torino, 1991, p. 6. For a discussion on managerial performance, see ZANDA G., *La valutazione dei dirigenti*, Cedam, Padova, 1984, p. 251.

[10] *Information* is the key word for financial accounting which affects investors' behavior and provides data that are significant for investors for evaluating the degree of success achieved by businesses and organizations.

any individuals that are interested in understanding and evaluating the success of a particular organization[11].

In this context, understanding the accounting for foreign currency transactions may mitigate the risk for financial accounting to be unfaithful and unreliable for a significant component of data and information expressed in foreign currencies that are expected to increase in such integrated global economy[12].

This field of accounting is even more relevant for holding companies that own interest in foreign countries, through entities – such as branches, subsidiaries, joint ventures, etc. – that, in compliance with their local law and regulations, maintain their accounts and financial statements in their local currencies. In general, multinational firms that have subsidiaries in several countries, not only have to deal with the problematic of currency conversion at individual level (intra-group and/or third parties transactions), but also have to appreciate that problem within the consolidated area[13]. In particular, for consolidated accounts purposes, the issue for an international group to consolidate one or more entities showing different functional currencies is of critical importance, since it may affect the preparation of both the parent company separate financial accounts – for the translation of the values of shares held in those foreign entities – and the consolidated accounts[14].

---

[11] AMADUZZI A., *Conflitto ed equilibrio di interessi nel bilancio dell'impresa*, Cacucci, Bari, 1949.
[12] ARRIGONI A., *Le poste in valuta estera tra bilancio e contabilità*, in *Giurisprudenza Commerciale*, 1994, vol. 21, 2, p. 313.
[13] ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, Roma, 2011, pag. 4.
[14] ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, cited, pag. 4. In this regard, it is worth reminding that for the purpose of preparing the consolidated financial statements, it is required that all consolidated entities adopt the same accounting principles. Where different accounting principles are applied by one or more entities pertaining to a certain group, specific accounting adjustments need to be made. See ZANDA G., *Il bilancio delle società. Lineamenti teorici e modelli di redazione*, Giappichelli, Torino, 2007.

Current accounting practices see two different methods for firms to disclose and manage, both at individual and at consolidated level, transactions that are denominated in a currency other than the reporting entity's functional currency. These methodologies are the following:

1. The *functional currency accounting*, according to which any single entity is required to identify the functional currency as the currency in which transactions are accounted for. In general terms, an entity's functional currency might be the currency of the country in which the entity is located (i.e., the local currency), the reporting currency of the entity's parent or the currency of another country.
2. The *multicurrency accounting* where business transactions are recorded in a variety of currencies other than the functional currency or the reporting currency. At group level, the multicurrency model implies that any single entity prepares its financial statements in local currency (i.e. the currency of the country in which the entity resides) and their accounts are then translated into the parent's functional currency.

Both the above accounting methodologies imply the necessity for firms of remeasuring foreign currency balances into a company's functional currency prior to the preparation of financial statements by identifying the proper conversion criteria.

3. Foreign currency transactions and remeasurement: from the translation of transactions to the translation of financial statements.

The preliminary key questions are: which problems may derive from the existence of foreign currencies and which are the relevant impacts on firms' performance measurement?

Accounting theory has recognized the existence of several problems arising from transactions denominated in currencies other than the entity's home currency, namely those affecting "the recording in the books of account and the presentation of financial statements", "the use of a multicurrency accounting and its integration into the general internal reporting", "the methodology for translating, for both the separate and the consolidated financial statements, the accounts of foreign entities, where the latter financial statements and those of the parent company are not denominated in the same currency"[15].

Briefly, an entity may be present in foreign markets and thus carry on foreign currency activities in different ways depending on the level of intensity of its presence in the foreign territory[16]. It may enter directly into transactions which are denominated in foreign currencies, whose values need to be translated into the currency adopted by the entity in order to measure its results and financial position in its home currency. Alternatively, it may conduct foreign operations through a foreign entity, such as a branch (i.e. a fixed place of management), a subsidiary or a joint venture that is located in a foreign country and whose financial accounts are maintained in its own currency. In this latter case, local accounts need to be translated to express the financial results of the separate foreign entity and include them in the parent entity's consolidated financial statements.

As a consequences of the above facts, the international literatures offers two board areas for the examination of the financial accounting aspects of foreign currency translation, such as the *translation of transactions* and the *translation of financial statements*.

The first issue concerns the recording of transactions denominated in foreign currency in the books of account of a single entity, and the subsequent

---

[15] ALBERTINAZZI G., BARONE E., *Aspetti contabili per le imprese non finanziarie dell'introduzione della moneta unica europea (euro), in* www.sdabocconi.it, p. 2.
[16] MAYR S., SANTACROCE B., *La stabile organizzazione delle imprese industriali e commerciali*, IPSOA, Milano, 2013, p. 129-130.

preparation of the financial statements of that entity from these books of account. This process refers to the translation of items' amounts that are fixed in terms of foreign currencies – e.g. for commercial, financial or contractual reasons – and need to be measured in terms of the currency adopted for accounting and reporting purposes.

The second issue is largely concerned with *presentation*, referring to as the process used for expressing the financial results of a separate entity so that it may be included in the parent entity's consolidated financial statements when the separate entity's functional currency is different from the parent's one. Differently from the translation of transactions, the process at hand is not to be intended as the remeasuring of foreign transactions in the home currency, but it merely refers to the re-expression of the set of financial statements into a different currency[17].

Although accounting for foreign currency matters has always been a challenging and important area in the field of accounting[18], both the Italian legislation and the legal doctrine have not given much attention to the problematic of foreign currency conversion. According to the extant literature, there is a debate regarding whether this problematic is more of a juridical essence rather than of a mere technical and accounting interest[19]. Whether or not this issue may be of a juridical rather than of a technical nature, the real problem lies in the goals and purposes of financial statements that are those to provide a true exposure position on the exchange rate fluctuation, so that both

---

[17] For a discussion on this topic, see ANDREI P., *Il bilancio consolidato nei gruppi internazionali. Metodologie di traduzione dei bilanci espressi in moneta non di conto*, Giuffrè, Milano, 1994, p. 88.

[18] See JAEGER P.G., *Accounting harmonization within the EEC*, in *Rivista del diritto commerciale*, 1992, I, p. 261-266. On the importance for multinational groups of the methodologies applicable to convert the financial statement of the foreign entity into the parent's home currency, see also BIANCHI L.A., *Informazione societaria e bilancio consolidato di gruppo*, Milano, 1990, p. 74.

[19] See ARRIGONI A., *Le poste in valuta estera tra bilancio e contabilità*, cited, p. 314.

the measuring and the reporting of the impact of exchange rate changes on foreign transactions is made possible[20].

4. Functional currency and translation of foreign currency transactions.

As explained in the previous section, translating foreign currency transactions basically concerns "the treatment of foreign currency transactions in the books of account and the financial statements of the individual company"[21].

Before investigating the currency conversion rules applicable to recognize and record transactions denominated in foreign currencies (i.e. currencies other than that adopted for books and records), an entity needs to identify its functional currency.

As highlighted in premise, the concept of functional currency is not a familiar concept in the Italian accounting culture[22].

In general terms, the functional currency should represent the currency that the entity usually adopts to denominate transactions. The other currencies

[20] D'ALESSIO L., *Le operazioni in moneta estera*, Giappichelli, Torino, 1991, p. 43. On this issue, see also RUTIGLIANO M., *L'utile da negoziazione in cambi delle banche*, in *Rivista dei Dottori Commercialisti*, 1986, 6 e 1987, 1, p. 957.

[21] "The books of account are usually denominated in the company's home currency. Therefore, before a transaction that is denominated in a foreign currency can be recorded in the books of account, it must first be translated. The practical necessity of recording a transaction in the books of account gives rise to the very simple rule that transactions denominated in a foreign currency are translated at the exchange rate ruling at the date that the transaction is recognized and recorded". See NOBES C., PARKER R., *Comparative International Accounting*, tenth edition, Prentice Hall, New York, 2008, p. 389.

[22] Important definitions of the concept of functional currency are offered by international accounting standards. In particular, the relevant standards dealing with this concept are the International Accounting Standard (IAS) 21 - *The effects of changes in foreign exchange rates* issued by the International Accounting Standards Committee (IASC) and the Statement of Financial Accounting Standards (SFAS) 52 governing *Foreign currency translation*. As previously noted, a more-in-depth discussion regarding the concept of functional currency is presented in Chapter Two.

are treated as foreign currencies[23]. With the setting up of the Euro as the common currency for several countries of the European Union (including Italy), Italian based entities commonly use the Euro to account for transactions and operations[24].

Once the functional currency is identified, transactions that are not denominated in the functional currency should be remeasured into the functional currency and the results of the remeasurement should be reflected in earnings.

In particular, transactions that are commonly involved in translating procedures may be, among others, (i) purchases or sales of goods or services where prices are stated in a foreign currency or (ii) loans payable or receivable in a foreign currency. These transactions need to be remeasured into the single entity's functional currency: this happens not only because the re-expression of accounting operations denominated in different currencies in an unique currency represents an operating necessity for defining a common measurement basis for income and capital of a going concern[25], but it is also

---

[23] "The functional currency should be determined by looking at several factors. This currency should be the one in which the entity normally generates and spends cash and in which transactions are normally denominated. All transactions in currencies other than the functional currency are treated as transactions in foreign currencies." See MIRZA, A. A., ORELL, M., HOLT, G. J., *IFRS: Practical Implementation Guide and Work Book*, Second Edition, John, Wiley & Sons, New Jersey, 2008, p. 159.

[24] In 1999, 11 Member States of the European Union agreed to set up a currency union (so called "European Monetary Union"), with the euro as common "book" money. Today, the euro currency area numbers 19 European Member States, including Italy (source: http://ec.europa.eu/economy_finance/euro/adoption/euro_area/index_en.htm).

Within the Italian legislation, the introduction of the Euro in Italy is governed by the Legislative Decree no. 213 of 24 June 1998 and it is force since 1st January 1999. Art. 16 of the cited decree provides for that starting from 1st January 2002, the adoption of the Euro is mandatory.

[25] For a discussion of this topic, see ZAPPA G., *Il reddito di impresa*, Giuffrè, Milano, 1937, p. 96 and in particular, paragraph titled "Income as a coordinated measument basis that is not capable of being split into separate components" on p. 396 and subsequent ones. On the same issue, see also TERZANI S., *Il bilancio consolidato*, Padova, 1979, p. 81, where it was affirmed that it seems to be "*logical that a unique currency is to be used to express values that are part of the same aggregate*". In accounting theory, this is also grounded in the general principle of comparability of financial statements (See ONIDA P., *Il bilancio d'esercizio nelle imprese e la sua «standardizzazione» e «certificazione»*, in *Problemi societari e fiscali di attualità*, Scritti in memoria di L. Antonelli, Milano, 1974, p. 5 and subsequent ones).

due to the existence of accounting rules and regulations for financial reporting for the statutory accounts of local companies[26].

As above mentioned, the translation process leads to the practical necessity of understanding the following main issues that are connected with translation:

1. Identifying which exchange rate should be used to translate the foreign currency value of assets and liabilities (e.g. the historical rate or the closing rate);
2. Considering how the change in the translated value of the assets and liabilities (the gain/loss on translation) should be reported in accounting and in financial statements.

Italian civil code provides for specific rules to recognize the foreign currency value of assets and liabilities in the financial statements[27]. In particular, fixed tangible assets, fixed intangible assets and fixed financial assets acquired through the outlay of foreign currency are accounted for in the financial statements by applying the exchange rate at the date the asset is purchased or, in case of a systematic depreciation of fixed assets and reduction to lower market value (as measured in the home currency), at the closing rate. This rule concerns the treatment of the so called non-monetary assets denominated in foreign currency and states that these assets will normally be valued on the basis of their historical rate, i.e. at their historical cost in terms of home currency. It derives that "all subsequent adjustments to this figure follow the normal rules of accounting, e.g. systematic depreciation in the case of fixed

[26] Art. 2423, par. 5, of the Italian Civil Code states that financial statements must be prepared in Euro units. The same obligation is provided for IAS adopters. In fact, Article 5 of the Legislative Decree no. 38 of 28 February 2005 (regarding the exercise of the options provided for in Article 5 of the EC Regulation no. 1606/2002 relating to IAS/IFRS), provides that "the financial statements of a single entity and the consolidated financial statements, prepared in accordance with the international accounting standards are prepared in euro, as per Article 16 of Legislative Decree of June 24, 1998 n. 213" (Art. 5, paragraph 2).

[27] See Art. 2426, par. 8-*bis*), of the Italian Civil Code, as introduced by Legislative Decree no. 6 of 17 January 2003, regarding the corporate law reform in force starting from 1st January 2004, and subsequently amended by the Legislative Decree no. 310 of 28 December 2004.

assets and reduction to lower market value (as measured in home currency) in the case of inventory. In effect, the fact that the assets were acquired by an outlay of foreign currency is no longer relevant, once the assets have been recorded in the books of account in terms of the home currency”[28].

Conversely, in case of monetary assets and liabilities (e.g. cash, account receivable, account payable) denominated in a foreign currency, the law provision currently in force provides for that these items are translated at the current rate of exchange, the latter meaning the exchange rate at the end of the reporting period[29]. The theoretical justification for this rule is that for monetary items, the historical cost in terms of home currency may no longer be the appropriate value to place on these items. This is firstly because the translation of this kind of items basically implies the valuation of a particular good that is the “money” that, due to its peculiar nature, needs to be valued by applying reasonable and objective criteria[30]. A further reason is that monetary items represent accounting balances that are still “open” as at the date of the reporting and hence, they cannot reflect an historical exchange rate movement[31]. For these reasons, the conversion at the closing rate appears to be the most appropriate methodology to provide a true and fair valuation, in a specific moment, of these kind of assets[32].

The different translation methods imposed by Italian law (and described above) for monetary items – whose main feature is that of being representative of the right to receive, or the obligation to pay, a certain amount of money –

[28] NOBES C., PARKER R., *Comparative International Accounting*, cited, p. 389.
[29] Under Art. 2426, par. 8-*bis*), of the Italian Civil Code.
[30] See ARRIGONI A., *Le poste in valuta estera tra bilancio e contabilità*, cited, p. 335-336.
[31] See ARRIGONI A., *Le poste in valuta estera tra bilancio e contabilità*, cited, p. 335-336.
[32] NOBES C. and PARKER R. stated that “Some accountants might justify its application on the grounds that, in a period of fluctuating exchange rates, the historical rate is as good a guide as the closing rate to the rate at which the debtor or creditor will be settled. Particularly in respect of long-term monetary assets and liabilities, it is considered premature to report a gain or loss arising from a fluctuation in exchange rates, which may be reversed in a future period. However, in the author’s opinion, this argument is invalid. It is contrary to basic accounting principles to report monetary assets at higher than their current values and liabilities at lower than their current values”. See NOBES C., PARKER R., *Comparative International Accounting*, cited, p. 390.

and for non-monetary items – that, on the contrary, are not representative of the above right and obligation – converge with those recognized by International Accounting Standards when financial accounts are presented in the same currency as that mainly adopted by companies in the course of their business[33]. In fact, under IAS/IFRS, foreign currency monetary assets and liabilities are translated using the closing rate, while non-monetary assets are translated using the historical rate, i.e. the exchange rate at the date the transaction takes place.

For the sake of completeness, it is worth adding that, in general, the translation of monetary items implies the reporting of a translation gain or loss. In this regard, Italian civil code[34] states that any gains or losses deriving from translation of such monetary items are accounted for in the income statement and in case a net gain arises, it must be included in a separate reserve of equity that is not distributable until the foreign currency asset/liability is realized. The justification for this provision resides in the prudence principle that is one of the basic accounting principles for financial statements purposes[35].

The recording of the translation gain or loss will be further examined in Chapter Two in light of the rules provided for by international accounting principles.

---

[33] ANDREANI G., TUBELLI A., *Iscrizione in bilancio e disciplina fiscale delle poste da regolare nella valuta funzionale (diversa dall'euro),* in *Il Fisco*, 2005, 30, p. 1–4664.

[34] Art. 2426, par. 8-*bis*), of the Italian Civil Code, cited.

[35] With reference to the criteria laid down the recording of the translation gain or loss, a relevant author claimed that not only the prudence principle needs to be followed for the financial statements purposes, but also the need to give a true and fair view of results is to be considered. See CAPALDO P., *La valutazione dei debiti di finanziamento a medio e lungo termine in moneta estera nel bilancio ordinario d'esercizio,* in AA.VV., *Scritti di Economia Aziendale per Egidio Giannessi,* vol. I, Pacini, Pisa, 1994, p. 255. A further discussion on this issue it offered by LACCHINI M., TREQUATTRINI R., *Ascesa e declino del principio di prudenza nel sistema contabile italiano: riflessioni critiche*, in *Rivista Italiana di Ragioneria e di Economia Aziendale*, luglio-agosto 2002.

5. Translation of financial statements of a foreign entity for consolidated reporting.

As already stated in paragraph 2, when an entity is engaged in foreign transactions through a foreign entity (e.g. subsidiary, branch, joint venture, etc.) that maintains its financial results in its own currency, it arises the necessity to translate the financial statements of the foreign entity into the reporting entity's (parent entity's) home currency for consolidating purposes.

Accounting theory recognizes different methods of translating the foreign entity's accounts into the consolidated financial statements. These methods are the current rate method, the temporal method, the current/non-current method, and the monetary/non-monetary method[36].

Under the current rate method, a single exchange rate could be used in the translation process for both balance sheet and income statement items[37]. In particular, it could be used[38], alternatively:

i. the exchange rate at the end of the period, both for assets and liabilities and for income and expenses items;
ii. the exchange rate at the end of the financial year for balance sheet items and the average exchange rate of the period for the income statements' items.

When integrating financial statements from a foreign entity, the application with the current rate method may result in an accounting gain or loss (i.e. exchange difference) for each of the asset and liabilities of the foreign entity that are denominated in foreign currency. More in detail, that is the case, for example, of a European parent company that prepares its financial

---

[36] SHAPIRO, A. C., *Multinational Financial Management*, Eighth edition, USA: John, Wiley & Sons, 2006, p. 339.
[37] This methodologies is also known as "single exchange rate method". See ANDREI P., *Il bilancio consolidato nei gruppi internazionali. Metodologie di traduzione dei bilanci espressi in moneta non di conto*, cited, p. 102 and subsequent.
[38] ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, cited, pag. 12.

statements in Euro and fully owns a subsidiary in the United States, the latter having financial results expressed in US Dollars: in case of an appreciation of the USD in terms of the Euro, a positive exchange difference (gain) may arise from the evaluation of a certain asset, while a depreciation of the same currency would lead to a translating loss. In other words, this method is consistent with a view of the foreign operation as an investment that is exposed to changes in exchange rates[39], since the translation process at the end of every reporting period leads to yearly aggregate values (expressed in the parent home currency) that reflect the worth of the foreign investment[40].

The temporal method – also known as historical method – implies the remeasurement of the foreign currency items on the basis of the valuation methods used for the foreign entity's assets and liabilities in its own local balance sheet[41]. In particular, under this method, assets and liabilities that are

---

[39] For a discussion on the exposure of multinational firms to currency risk, see TUTINO F., *Il controllo di gestione dei rischi di cambio nelle imprese e nei gruppi aziendali*, in Banche e Banchieri, 1, 1989. FRANCALANCIA L., *Il rischio di cambio nel bilancio consolidato di imprese multinazionali,* Sistema, Roma, 1984.

[40] ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, cited, pag. 13. This author also highlights how some criticism exists in the use of the current rate method in those cases where the financial statements items of the foreign entity are locally valued at their historical cost (historical cost accounting). In fact, this accounting principle appears to be in contrast with an evaluation of assets and liabilities (pertaining to the foreign entity) that is at current value, as this happens under the method at hand. On this argument, see also DEZZANI F., *Il bilancio consolidato e le società estere: i metodi di conversione in moneta italiana dei loro bilanci*, in AA.VV., Scritti di Economia Aziendale per Egidio Giannessi, vol. I, Pacini, Pisa, 1994, p. 529.

[41] "The essence of the temporal method is that the valuation methods used for the subsidiary's assets and liabilities in its own balance sheet should be retained in the translated financial statements. There are several different methods used in valuing assets in the balance sheet. They may be classified as follows:

1. Historical cost: the amount of cash (or resources of equivalent value) actually paid out in the past in order to acquire the asset.
2. Current replacement cost (CRC): the amount of cash that would have to be expended by the company at the balance sheet date to acquire a similar asset.
3. Net realizable value (NRV): the amount of cash that the company would receive (net of expenses) if it were to sell the asset at the balance sheet date.
4. Value of future receipts: debtors and other amounts receivable are stated at the amount of cash that the company expects to receive in the future. Similarly, creditors and other liabilities are stated at the amount of cash that the company expects to be obliged to pay out in the future in order to redeem the liability.

carried in the books at historical cost are translated at the historical exchange rate, while assets and liabilities carried in the books at their current value (e.g. the replacement cost, the net realizable value and the fair value) are translated at the current rate (i.e. year-end rate)[42]. Therefore, a different rate is applied to each class of items to the extent that different measurement basis exist to account for assets and liabilities in the financial statements of the foreign entity[43]. As to the translation of the income and expenses items, these latter may be translated by applying the exchange rates at the date of each transaction or at the annual average rate[44].

Although Italian accounting literature recognizes the described temporal method as that highly grounded in accounting theory, international literature and practice also divide the temporal method into two possible types on the basis of the translation criteria applicable to the balance sheet items. These further methods are known as the current/non-current method and the monetary/non-monetary method.

The current/non-current method means that all current assets and current liabilities are translated at the current rate of exchange at the end of the reporting period, while non-current assets (e.g. fixed assets) and non-current

---

For each of these four methods of valuation, a particular date pertains to the money amount at which a subsidiary's asset is valued, and this shows the exchange rate to be used in its translation". See NOBES C., PARKER R., *Comparative International Accounting*, tenth edition, Prentice Hall, New York, 2008, p. 399.

[42] It has been observed that "a strict, although theoretical, application of the temporal method, would lead to identify the temporal nature of each statutory item, in order to translate them on the basis of an *ad hoc* exchange rate that might be referred to the exchange rate either at the recording or at the payment date" (ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, cited, pag. 14).

[43] ANDREI P., *Il bilancio consolidato nei gruppi internazionali. Metodologie di traduzione dei bilanci espressi in moneta non di conto*, cited, p. 108 and 109. The same author sustained that this application of the temporal method is well grounded in accounting theory: in effect, "the translation of the foreign entity's financial results on the basis of their accounting measurement basis leads the consolidated financial statements to be viewed as an unitary system of values, as if the separate foreign entity would have never been existed. The accounting treatment of each single class of values pertaining to the foreign operation, properly translated, is therefore the same as that that would have been applicable if those transaction were to be accounted for directly in the books of accounts of the parent entity" (ANDREI P., cited, p. 109).

[44] As a matter of principle, the average rate of the period may be used as long as such rate is not subject to significant fluctuations.

liabilities (e.g. long-term loans) are translated at their historical exchange rate. The historical exchange means the exchange rate in effect at the time that an asset was acquired or a liability incurred[45]. The essence of this method is that the translating process regarding the balance sheet items of the foreign entity is based on the realization criteria prescribed by the accounting theory for each class of items[46]. This current/non-current method permits to remove all of the effects of foreign exchange rate fluctuations from fixed capital items, since the impacts of exchange movements are merely on current assets and liabilities.

The monetary/non-monetary method is, on the contrary, based on the classification of assets and liabilities as monetary and non-monetary items[47]. In particular, monetary assets and liabilities are translated at the current rate of exchange and non-monetary ones are translated at historical rate. Therefore, according to this translating methodology, a risk exposure from currency fluctuations exists only for monetary assets and liabilities.

Under both the current/non-current and the monetary/non-monetary methods, the translation process of items of income and expense is consistent

[45] SHAPIRO, A. C., *Multinational Financial Management*, cited, p. 339-340.
[46] In simplest terms, for the purpose of the translation, items are classified on the basis of their permanency in course of the business. This implies the necessary to identify the notion of "short permanency", so that a distinction between current and non-current assets and liabilities is made possible. See FERRERO G., DEZZANI F., PISONI P., PUDDU L., *Le analisi di bilancio*, Giuffrè, Milano, 1994, p. 68. For further analysis on the classification of balance sheet items see the following authors: CODA V., BRUNETTI G., BARBATO BERGAMIN M., *Indici di bilancio e flussi finanziari*, Etas, Milano, 1974; CATTURI G., *Le analisi di bilancio con particolare riferimento all'aspetto finanziario della gestione*, Emmeci, Siena, 1989; BRUNETTI G., *Le riclassificazioni delle sintesi di bilancio*, in BRUNETTI G., CODA V., FAVOTTO F., *Analisi, previsioni, simulazioni economico-finanziarie d'impresa*, Etas, Milano, 1991; CARAMIELLO C., DI LAZZARO F., FIORI G., *Indici di bilancio: strumenti per l'analisi della gestione aziendale*, Giuffrè, Milano, 2003; GIUNTA F. (a cura di), *Analisi di bilancio: teoria e tecnica*, Copisteria II Prato, Firenze, 2004; INVERNIZZI G., MOLTENI M., *Analisi di bilancio e diagnosi strategica*, Etas, Milano, 1990; MATACENA A., TIEGHI M., *Dal bilancio d'esercizio alle analisi di bilancio: le riclassificazioni, gli indici ed i flussi*, in MATACENA A., TIEGHI M., *Il bilancio d'esercizio*, Clueb, Bologna, 1997; MECHELLI A., *Il rendiconto finanziario consolidato: profili teorici e comportamenti aziendali*, Cedam, Padova, 2008; PAGANELLI O., *Analisi di bilancio*, Utet, Torino, 1986; PODDIGHE F. (a cura di), *Analisi di bilancio per indici*, Cedam, Padova, 2004; RANALLI F., *Sulla capacità informativa delle strutture di bilancio*, Cedam, Padova, 1984.
[47] It is reminded that monetary items are those which represent the right to receive or the obligation to pay a certain amount of money, such as cash, receivables and debts payables, while non-monetary items are the remaining balance sheet items, such as fixed assets, inventory, net equity components, etc.

with the principles followed for translating the balance sheet items. This means that income and expenses referring to balance sheet items are translated at the same exchange rate as that used for the translation of the underlying asset – that is, the historical rate for assets valued at historical cost, and the closing rate for assets valued at current value or, alternatively, the average rate for the period[48].

Italian civil code does not regulate the methodologies of translating the foreign entity's accounts into the consolidated financial statements. Some interpretations are issued by the Italian GAAP 17 (last version dated August 2014). In particular, this standard (par. 125 and 126), as currently in force, provides that the foreign entity's financial statements shall be converted from its local currency into the parent's functional currency, by applying the following criteria:

a. assets and liabilities shall be translated at the year – end rate;
b. income and expenses shall be translated by applying the exchange rates at the date of transaction or at the annual average rate (as long as such rate is not subject to significant fluctuations);
c. an exchange difference arises from the translation of the values which shall be recognised in consolidated net equity.

Based on the above, the method currently applicable under the interpretation of the Italian GAAP no. 17 is the current rate method[49] that is substantially the same as that provided by IAS 21.

---

[48] ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, cited, pag. 17.

[49] A previous version of the Italian GAAP no. 17 of March 1996 recognized both the current rate and the temporal methods for the translation of the foreign entity's financial statements. This version was then replaced on 16 September 2005.

6. Translation of foreign branches' accounts

A further circumstance in which there is the need to translate foreign accounts is the case of a company having one or more branches in foreign states[50]. These entities are commonly known as foreign "permanent establishments"[51] and are deemed to be "substructures" of the enterprise[52]. The peculiarities of these entities are the following:

- on the one hand, the lack of any juridical independence from the enterprise – as they represent branches or divisions whose activities are integrated with that of the enterprise[53], and
- on the other hand, an organizational and accounting autonomy[54].

It derives that the foreign branch may maintain its books and accounts in the currency used in the country where it is sited, even though the latter currency is different from that adopted by the enterprise[55].

---

[50] It is clear that for many companies of continental Europe, this issue arises in those cases in which the branch accounts are expressed in a currency other than euro.

[51] It must be firstly premised that, in principle, the purpose of the concept of a permanent establishment is to determine the right of one State to tax the profits of a non-resident enterprise that carries out one (or more) business activity within that State's territory. The permanent establishment is defined by Article 5 of the OECD Model Tax Convention (last version dated 15 July 2014) as a "fixed place of business through which the business of an enterprise is wholly or partly carried on". Under this Article, the term "permanent establishment" includes a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

[52] COSSAR L., *Attività d'impresa in valuta estera e rischio di cambio. Aspetti contabili e di bilancio*, Giuffrè, Milano, 2004, p. 52 and subsequent ones.

[53] See Italian GAAP 26 of August 2014, par. 39. In principle, foreign entities are treated as carrying on activities integrated with that of the enterprise if they are deemed to be a mere "extension" of the enterprise. More in detail, it has been noted that an *integrated foreign entity* is deemed to exist if its business activities are an integral part of the enterprise and therefore, they impact on the business results and cash flows of the enterprise. See MAYR S., SANTACROCE B., *La stabile organizzazione delle imprese industriali e commerciali*, IPSOA, Milano, 2013, p. 151.

[54] MAYR S., SANTACROCE B., *La stabile organizzazione delle imprese industriali e commerciali*, cited, p. 136. For an analysis on the concept of permanent establishment, see among others, PIAZZA M., *Guida alla fiscalità internazionale*, Il Sole 24 Ore, Milano, 2004; DRAGONETTI A., PIACENTINI V., SFONDRINI A., *Manuale di fiscalità internazionale*, IPSOA, Milano, 2012.

[55] It is reasonable that the books and accounts of a foreign branch are kept in compliance with the accounting rules and practices of the foreign country where the branch is established. This means that its accounts shall present the language, the structure and the currency commonly

On the other hand, the enterprises are required to integrate their books and accounts with the financial results of their foreign permanent establishments. In particular, Italian companies having permanent establishments in a foreign state are obliged to include in their accounting system the records of the foreign permanent establishment by means of a specific section of accounts in which the branch's financial results are separately determined[56].

The coordination between the branch's foreign accounts and the company's accounting system is normally made by means of transitory accounts whereby

- balances related to assets and liabilities pertaining to the foreign permanent establishment are recorded at beginning and at the end of the period;
- balances related to income and expenses of the foreign permanent establishment are recorded at the end of the period;
- balances related to transactions made between the foreign permanent establishment and the company are recorded in the course of the period[57].

It may happen that the inclusion of the branch's results into the company's accounting system would be contingent upon the translation of the foreign currency results of the permanent establishment.

Italian law, currently in force, does not govern the translation of foreign permanent establishment's accounts from its local currency into the

---

used in that foreign country. See GIANNETTO G., *La stabile organizzazione nel sistema dell'imposizione diretta: con particolare riferimento alla stabile organizzazione all'estero di società residente in Italia*, in *Il Fisco*, 1999, 45, p. 13944.

[56] See art. 14, paragraph 5, of Presidential Decree no. 600 of 1973. It is worth noting that Italian law does not provide for any operational indications on how the branch's transactions are to be included in the company's accounting system. Hence, Italian companies are free to choose the proper accounting technics in order to integrate the branch's results in their accounting systems.

[57] ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, cited, pag. 11.

enterprise's functional currency. An (unique) interpretation on this issue is offered by the Italian GAAP 26 (last version dated August 2014) whereby it is stated that "foreign permanent establishments are deemed to be structures […] (e.g., divisions, branches or offices) whose activities is integrated with that of the company that prepares the financial statements; hence, in order to include the branches' results in the company's financial statements, the former are translated by applying the conversion criteria described in GAAP 17".

The reference to the criteria laid down in GAAP no. 17 implies that the foreign branches' results are translated by applying the same method recognized to translate the financial statements of a foreign entity for consolidated reporting, i.e. the current rate method.

In this regard, it has been observed that a more correct method in the case of permanent establishments would have been the temporal method, since this latter methodology is more suited for the translation of foreign results related to entities carrying on business activities that are integrated with the enterprise[58].

The reason for this is that under the the temporal method, the translation process is based on the same criteria that would have been applied if the branch had used the same functional currency as that used by the company (in other words, if the separate foreign entity had never been existed).

7. The multicurrency accounting: rules and practices of multinational companies.

As highlighted in previous paragraphs, in today's high-tech and international economy, global actors operate in a multicurrency environment, thus frequently entering into and managing transactions that are initiated an

[58] MAYR S., SANTACROCE B., *La stabile organizzazione delle imprese industriali e commerciali*, cited, p. 152. See also FELIZIANI C., *Differenze cambio emergenti dalla conversione dei saldi delle stabili organizzazioni estere. Trattamento contabile e disciplina fiscale*, in *Il Fisco*, 1996, 3, p. 582.

settled in one or more currencies. The process of internationalization of companies has shown the need for a clearly defined role of multicurrency accounting as a mean to process and manage records in multiple currencies[59].

The multicurrency accounting may be adopted not only at group level – where any single entity prepares its financial statements in its local currency and they are then translated into the parent's functional currency – but also at individual level.

The multicurrency accounting approach has the merit, on the one hand, to reflect the true exposure position of each currency whose transaction value is expressed[60] and, on the other hand, to reduce the administrative burden and simplify the accounting procedure in reporting systems[61].

Italian civil code does not cover, either implicitly or explicitly, the discipline of multicurrency accounting. A specific reference of this regime is contained in the Italian tax rules that govern taxation in the field of foreign currency translation[62]. Article 110, paragraph 2, third sentence, of the Presidential Decree no. 917 of 26 December 1986 (the so called "Income Tax Consolidated Code" or "ITC") allows companies entertaining habitual relations in a foreign currency to adopt the multicurrency accounting system in order to

---

[59] In order to define this role clearly, IAS 21 has been developed by the International Accounting Standards Committee (IASC) to offer common accounting principles at international level. IAS 21 provides authoritative guidance on foreign currency matters normally faced by multinational structures.

[60] DUANGPLOY O., OWINGS G.W., *The comparability of multicurrency accounting with functional currency accounting*, in *The International Journal of Accounting*, 1997, vol. 32, 4, p. 443. The author argues that "having information capable of revealing the position of each hard currency will benefit stakeholders who wish to assess exposure and to gauge the effectiveness with which foreign exchange risk is managed. Although it is currently technically feasible to provide such detailed, disaggregated data, management may be reluctant to supply such useful information to investors unless it is mandated by regulations and/or competitive market pressures" (cited, p. 443).

[61] DI RESTA G., FABIO M., *La contabilità plurimonetaria*, in *Il Fisco*, 2002, 43, p. 1–6812.

[62] It particular, given the lack of accounting rules in this field, it is necessary to refer to other rules such as those in tax regulations, that can be deemed to be of a supplementary and explanatory nature. See ALBERTINAZZI G., *La contabilità plurimonetaria. Ammissibilità e convenienza*, in *Rivista dei Dottori Commercialisti*, 1991, 5, p. 873.

facilitate them in the recording proceedings[63]. This rule represents a general clause[64] that permits all entities having habitual commercial and financial interest in different currencies to implement and develop recording procedures based on a multicurrency approach, notwithstanding the single reporting currency concept that lies in accounting principles[65].

Under the multicurrency accounting, financial amounts are reported by the separate entity in their relevant currencies rather than being remeasured in the single reporting currency. In particular, with the multicurrency accounting approach, the transactions are recorded directly in the foreign currency in which they are regulated, without for them to be translated into the functional currency at the time the transactions are made. This implies that the accounting picture does not involve only one currency (i.e. the reporting currency) since it includes both records that are expressed in the home currency of the separate reporting entity and account balances in foreign currencies.

With multicurrency reporting, a specific section of accounts is created in the books of accounts for each currency habitually managed by an entity: at the end of each financial period, each section is closed and thus a partial financial result regarding the position of each currency arises. This result represents the

[63] The cited provision was introduced by Art. 1, par. 1, lett. *r*) of Law Decree no. 416 of 29 June 1994, converted and amended by Law no. 503 of 8 August 1994, and was effective starting from fiscal year 1993. This introduction was an important consequence of the currency liberalization that occurred in the 1990s which made possible the liberalization of, and relevant increases in, international trade and foreign direct investment. In this context, there was the need for national companies operating within international markets to adopt multicurrency accounting systems so that global operations dealt in different currencies could be reflected in accounting.

[64] The recording of business transactions in a variety of currencies other the reporting currency is also addressed by the Italian generally accepted accounting principles (GAAP no. 26, last version dated August 2014).

[65] Before the currency liberalization took place, the multicurrency accounting was merely allowed for those Italian based entities that were authorized, due to the particular business activities carried out, to hold bank accounts in foreign currencies – they were the so called "authorized accounts" ("*conti autorizzati*") and the "special accounts held in foreign financial institutions" ("*conti speciali all'estero*"). For a discussion on this issue, see ALBERTINAZZI G., *La contabilità plurimonetaria. Ammissibilità e convenienza*, cited, p. 873-877.

(sole) exchange difference (profit or loss) that impact the business performance of the entity[66].

Under a procedural point of view, in principle, multicurrency accounting may be implemented both for monetary items and for income and expenses items that relate to transactions denominated in a foreign currency. In particular, there exist two possible methodologies to apply the multicurrency accounting[67]:

1. the use of a set of accounts that merely include debit, credit and cash balances (i.e. monetary items) denominated in a foreign currency[68];
2. the use of a set of accounts that include both monetary items and income and expenses items[69].

When a separate entity intends to apply the multicurrency accounting the methodology *sub* 1 is to be followed. In this case, in addition to those accounts that are held in the home currency, further accounts are used as part of the total books of accounts to record monetary amounts related to transactions which are exposed to foreign exchange movements[70]. More in detail, during a certain financial period,

a) at the time a foreign currency transaction is made, a transitory account (e.g. "Financial position in foreign currency A") is set up in the general

---

[66] DI RESTA G., FABIO M., *La contabilità plurimonetaria*, cited, 2002, 43, p. 1–6812.
[67] COSSAR L., *Attività d'impresa in valuta estera e rischio di cambio. Aspetti contabili e di bilancio*, cited, p. 26 and subsequent ones.
[68] COSSAR L., *Attività d'impresa in valuta estera e rischio di cambio. Aspetti contabili e di bilancio*, cited, p. 28-42. This methodology for multicurrency recording is applicable to individual companies that are habitually engaged in foreign transactions (e.g. sales, purchases, loans, etc.) that are an integral part of its business. See DI RESTA G., FABIO M., *La contabilità plurimonetaria*, cited, 2002, 43, p. 1–6812.
[69] COSSAR L., *Attività d'impresa in valuta estera e rischio di cambio. Aspetti contabili e di bilancio*, cited, p. 43-51.
[70] This is the case, for example, of a debt account (e.g. "Accounts payable") that is split into two or more sub-accounts for each currency used (e.g. "Accounts payable in US Dollars", "Accounts payable in Yen", etc.).

ledger to record the home currency (e.g. Euro) amount of transaction in foreign currency (e.g. USD)[71];

b) subsequently, the transaction in foreign currency is recorded in two accounts denominated in that foreign currency: one account named “Financial position in foreign currency A” and another account to record the debt or credit in foreign currency, e.g. “Foreign Clients USD”, “Foreign Suppliers Yen”, etc.);

c) at the end of the reporting period, each account regarding the debt or credit in foreign currency is closed and the relative balance (in foreign currency) is translated by applying the closing exchange rate. This amount is translated in the home currency and then recorded in the account named “Financial position in foreign currency A”. Any exchange gain and loss on such monetary items should normally be reported as part of the profit or loss of the period in accordance with the accruals concept of accounting.

For the sake of completeness, it is worth noting that when multicurrency accounting is used at group level (e.g. to translate foreign accounts held by foreign branches or subsidiaries), both the monetary items and income and expenses items deriving from transactions in foreign currencies are recorded in specific accounts held in foreign currencies. In this case, these latter accounts are translated into the home currency at the closing rate. Since both the monetary and the economic results in foreign currency are translated at year-end, an exchange difference may need to be recognized to the extent that the closing rate differs from the previous year closing rate.

[71] The amount recorded in the account named “Financial position in foreign currency A” represents the debt or credit amount – translated from the foreign currency into the home currency – arising from the transaction in foreign currency (USD). The related expense or income is recorded in the books of accounts (held in home currency) by applying the exchange rate at the date of transaction.

7.1 The multicurrency accounting versus the functional currency accounting.

In principle, assets and liabilities arising on transactions denominated in foreign currency may be recorded in the books of account by initially being remeasured into the home currency; as an alternative approach, their amounts may be maintained in their relevant currencies, thus restating accounts into the home currency at the time the translation is effectively made[72]. The above cited approaches represent, respectively, the functional currency accounting and the multicurrency accounting.

The functional currency accounting is based on a single currency concept for financial reporting in a multicurrency economic environment. The fundamental idea of this approach is the need for business transactions denominated in a foreign currency to be recorded in one single currency, that is normally the currency of the primary economic environment in which an entity operates (normally, the home currency). This requires that any transaction denominated in a currency other than the home currency needs to be remeasured into this latter currency for reporting purposes[73].

Over the past twenty years, a series of articles has cited the inadequacy of the existing reporting systems with the changing business world[74]. The idea was that the increasing globalization in the business did necessitate new

---

[72] COSSAR L., *Attività d'impresa in valuta estera e rischio di cambio. Aspetti contabili e di bilancio*, cited, p. 21.

[73] The main issue relates to the choice of the currency to be used as functional currency for reporting purposes, that is the currency unit that enables to create homogeneous financial data and information for the measurement of income and equity of a certain entity. See MASINI C., *Lavoro e risparmio*, Utet, Torino, 1987, p. 113 and subsequent ones.

[74] See, among others, DUANGPLOY O., OWINGS G.W., *The compatibility of multicurrency accounting with functional currency accounting*, cited, p. 442-443; WALLMAN S. M. H., *The future of accounting and disclosure in an evolving world: the need for dramatic change*, in *Accounting Horizon*, 1995, p. 81-91; ZAROWIN S., *The future of finance*, in *Journal of Accountancy*, 1995, p. 47-49; DI RESTA G., FABIO M., *La contabilità plurimonetaria*, cited, 2002, 43, p. 1–6812; ANDREANI G., TUBELLI A., *Iscrizione in bilancio e disciplina fiscale delle poste da regolare nella valuta funzionale (diversa dall'euro)*, in *Il Fisco*, 2005, 30, p. 1–4664.

reporting system and disaggregated information appeared to be growing in importance[75].

More in detail, it has been affirmed that "having information capable of revealing the position of each hard currency will benefit stakeholders who wish to assess exposure and to gauge the effectiveness with which foreign exchange risk is managed. […]. The potential loss of sensitive information is an important consideration that management will need to consider"[76].

In this context, multicurrency accounting represents an effective tool to meet both the needs of internal management and those of investors, who are the sponsors and users of financial information and data, by efficiently informing them of foreign currency exposure.

Accounting theorists have also advanced the issue on whether the integration of several currencies into the internal reporting systems may be in conflict with the single currency reporting concept that lies in measuring and reporting financial results and pursues to provide homogeneous financial information[77]. It has been concluded that the issue of assessing whether the need for recording transactions directly in their foreign currencies prevails on the necessity of measuring financial results in a single currency is contingent upon the type of operations in foreign currency that an entity makes within the course of its business. More in detail, if a foreign currency transaction is a direct and integral part of the business operations and strategy, the need for

---

[75] It was found that traditional, aggregated corporate information was a product of past technology and that accountants were therefore challenged to consider whether more useful information could be generated by distributing disaggregated raw data to users (WALLMAN S. M. H., *The future of accounting and disclosure in an evolving world: the need for dramatic change*, cited). A further discussion on the need for, and the usefulness of, disaggregated information is also offered by IJIRI Y., *Segment statements and informativeness measures: managing capital vs managing resources*, in *Accounting Horizons*, 1995, p. 55-67.

[76] DUANGPLOY O., OWINGS G.W., *The compatibility of multicurrency accounting with functional currency accounting*, cited, p. 443.

[77] It is clear that the necessity of measuring financial results in a single currency so that homogeneous results are provided to financial statements users appears to be in contrast with the need of recording, where possible, transactions directly in one or more foreign currencies in which they are regulated. See ALBERTINAZZI G., *La contabilità plurimonetaria. Ammissibilità e convenienza*, cited, p. 884.

translating that operation into the home reporting currency should prevail, meaning that the functional currency approach should be applied. On the contrary, if the foreign currency transaction is part of a proper foreign operation of the reporting entity (i.e. a distinct and separable set of operations in one or more currencies conducted by an entity), it should be reasonable that the need for recording that transaction directly in that foreign currency would prevail.

This approach is supported by the IAS 21 that provides an international authoritative guidance on foreign currency translation[78]. This international principle distinguishes between single foreign transactions and separate foreign operations. In the former case, IAS 21 suggests to translate the foreign amount by applying the exchange rate at the date the transaction takes place and in the latter case, it is allowed for the foreign operation to maintain books and accounts in (one or more) foreign currencies.

Based on the above principle, it could be sustained that the multicurrency accounting is allowed and recommended for companies having one or more separate foreign operations in a foreign currency and not for mere transactions that are regulated in foreign currencies.

While at group level, the multicurrency reporting is permitted to those parent companies that have foreign entities such as foreign subsidiaries, branches, joint ventures, etc., at individual level, it becomes necessary to assess whether an entity is managing a foreign operation and not a mere set of transactions denominated in foreign currencies. It follows that if a foreign operation is deemed to exist within the business of a single entity, the latter should be entitled to adopt the multicurrency accounting, so that the various currencies can be presented as part of the total accounting picture.

As highlighted in premise, the multicurrency approach enables recording transactions and monitoring assets and equities in all currencies and in one

[78] See *Principi Contabili Internazionali elaborati dallo I.A.S.C. (Principio n. 21)* in TOMASIN G., *I principi contabili internazionali*, 1983, IREO, p. 301 and subsequent ones.

reporting system, having therefore the merit of portraying the true economic position of each currency and evaluating and controlling the foreign currency risk.

8. Translation and the use of language as a means of communication in accounting.

Another issue that may involve multinational enterprises is the use of a foreign language to keep their books and accounting records. The most important reasons for this is that multinational enterprises have headquarters in more than one country or they have substantial commercial operations in several countries.

Over the last few decades, Italian accounting theory has been engaged in continual debate regarding the possibility for enterprises to keep the mandatory books and accounting records in a foreign language other than the Italian one. This issue is very relevant especially for those enterprises carrying out their business not only in the national context, but rather in an international dimension.

The analysis is to be made having regard to the provisions of the Italian civil code governing the rules and procedures for bookkeeping. In this regard, article 2219 of the Italian civil code, governing the keeping of accounts, provides for a general formal rule according to which books and accounts have to be kept in accordance with the rules of orderly accounting and specific formal requirements to disclose accounting information must be respected[79]. The cited provision does not prescribes any rule concerning the type of

[79] In particular, article 2219 ("Keeping of accounts") of the Italian civil code states that "All records shall be kept in accordance with the rules of orderly accounting, without leaving blank spaces, interlineations, or marginal notations. No erasures can be made, and if it is necessary to make any cancellation, it shall be done in such manner as to leave legible the cancelled words".

language to be adopted in drafting the book and accounting records, nor it exists an official language to be used for bookkeeping purposes[80].

In this regard, three different theories have been developed in accounting around the issue of the language to be used in bookkeeping.

According to a minor theory[81], the sole language to be used in drafting the accounting records is the Italian one.

Under a boarder accounting theory[82], in the absence of any specific obligation stated by law, companies are deemed to be free to choose the language to be adopted for their books and accounts. In particular, this theory has advanced that the freedom in choosing the language in accounting is assumed in the absence of any precise legal indication in this topic. Under this theory, the use of a foreign language other than the Italian should not be in contrast with the probative function of this documentation[83], since it is however possible to translate the accounting records upon the request of the relevant authority.

In this scenario, some theorists have advanced an intermediate position on this issue according to which the use of a language other than the Italian one is deemed to be acceptable to the extent that a real and concrete justification exists – for example, the company is part of a multinational group having substantial commercial operations and interest in several countries[84]. More in detail, this intermediate theory recognizes that Italian companies are free to

[80] PORPORA F., STANCATI G., *Si può tenere la contabilità in lingua straniera?*, in *Dialoghi di diritto tributario*, anno I, 2, p. 291 and subsequent ones.
[81] COTTINO G., *Diritto commerciale*, I, Padova, 1993, p. 224.
[82] See BOCCHINI E., *Le scritture contabili*, in *Manuale di diritto della contabilità delle imprese*, I, Torino, 1989, p. 69 and subsequent ones; FERRI G.B., *Scritture contabili* (voce), in *Enciclopedia del diritto*, XLI, Milano, 1989, p. 820; NAVARRINI U., *Trattato elementare di diritto commerciale*, II, Torino, 1935, p. 41; VIVANTE C., *Trattato di diritto commerciale*, I, Milano, 1928, p. 188.
[83] Articles from 2709 to 2711 of the Italian civil code provides that the books and other accounting records of enterprises subject to registration constitute evidence against the enterpriser.
[84] See NIGRO A., *Libri e scritture contabili* (voce), in *Enc. giur. Treccani*, XIX, Roma, 1990, p. 2; CASANOVA M., *Impresa e azienda*, in *Trattato di diritto civile italiano*, directed by VASSALLI F., Torino, 1974, p. 278; PANUCCIO V., *La natura giuridica delle registrazioni contabili*, Napoli, 1964, p.68 and subsequent ones.

choose the language to adopt for their books and accounts but this freedom is contingent upon the existence of a functional reason that justifies the use of a language other than Italian. In the lack of a concrete reason, the books and accounts may be deemed to be non-conform[85].

As a general principle, it can be argued that the role of bookkeeping in a business organization is to offer a picture of both the events and monetary results that occur in the course of the business. Bookkeeping is therefore an internal administrative procedure that enables the owner of a certain company to easily control the company's performance and developments. On the other hand, books and accounts may also have, in certain circumstance, the role of providing to third parties a complete, true and fair view of the business activity carried out[86].

The important role played by bookkeeping implies the need to apply a clear and complete recording procedure in accordance with the rules of orderly accounting as stated by article 2219 of the Italian civil code, so that bookkeeping may represent a proper means of communication of business information and results. As such, it should be considered denied in accounting the use of those languages that do not represent an adequate means of communication, such as the "dead" languages or the codified languages[87].

On the contrary, when the use of a certain language represents a means of communication that is commonly accepted and it is due to objective business reasons, there should not be any legal constrains in its adoption in accounting. This is the case of the English language that is broadly accepted as a means of communication and its use is objectively justified by organizational and administrative reasons of international groups[88]. In other words, English can be

---

[85] CASANOVA M., *Impresa e azienda*, cited, p. 278.

[86] NIGRO A., *Imprese commerciali e imprese soggette a registrazione*, in *Tratt. dir. priv.*, directed by RESCIGNO P., XV, Torino, 2001, p. 717.

[87] ASSONIME, *La validità civilistica della tenuta delle scritture contabili in lingua inglese*, case no.1, 2015, p. 9.

[88] ASSONIME, *La validità civilistica della tenuta delle scritture contabili in lingua inglese*, case no.1, 2015, p. 9.

deemed to be the language of business and therefore its adoption in accounting should be considered as acceptable if justified by business reasons.

Therefore, when there are objective functional reasons – such as the foreign nationality of the entrepreneur, the peculiar nature of the business or the inclusion in a multinational group – it should be allowed for enterprises to adopt in accounting a language other than the Italian one to the extent that the language used is widely accepted in the business world.

Only in case books and accounting records are used as evidence against the enterprise in a controversy – as stated by article 2709 of the Italian civil code – it would be necessary that books and accounting records held in a foreign language are translated into the Italian language so that they could be submitted in the litigation spontaneously or upon request from the court.

9. Foreign currency translations in the Italian tax legislation: some highlights.

This paragraph aims at providing an overview of the main tax provisions and rules currently in force that govern foreign currency matters within the Italian tax law. A specific analysis of the tax implications that may derive from the application of a functional currency other than Euro for IAS adopters is provided in Chapter Three (see paragraph 8.2).

Foreign currency matters are dealt with in articles 9 and 110 of the Presidential Decree no. 917 of December 22, 1986, (hereafter also "Income Tax Consolidated Code" or "ITC").

In particular, article 110 (concerning general rules on valuations, for corporate income tax purposes), paragraph 2, currently in force, provides for that "in determining the normal value of goods and services, and with reference to the date on which they are considered earned or incurred, the provision of article 9 shall apply, unless otherwise provided, to the valuation of revenues, receipts, expenses and charges […] in foreign currency; nevertheless, revenues, receipts, expenses and charges in foreign currency earned or actually incurred on an early date shall be valued with reference to such date". The cited provision refers to article 9 (regarding calculation of profits and losses) governing the conversion criteria that are relevant for tax purposes.

In particular, article 9, paragraph 2, currently in force, states that "in calculating profits and losses, revenues, receipts, expenses and charges in foreign currency shall be valued by applying the exchange rate on the day on which they are received or sustained or exchange rate of the nearest prior day, or failing that, of the month in which they are received or sustained; […]".

Based on the aforementioned provisions, any proceeds and expenses deriving from transactions that are regulated in a foreign currency shall be converted into the home currency by applying the exchange rate on the date on which the transaction takes place[89].

Furthermore, article 110, paragraph 2 of the ITC provides for an explicit provision to convert the foreign permanent establishments accounts. This rules states that these latter accounts are converted to euro by using the exchange rate of the date on which the fiscal year ends; any exchange difference that may arise with respect to the account balances of the previous fiscal year is not relevant for tax purposes. This provision explicitly clarifies that there is no obligation to convert each single transaction made by the foreign permanent establishments into the home currency[90]. The foreign branch may in fact prepare its financial accounts in its local currency and these latter are then

---

[89] It must be preliminary noted that the Italian tax law currently in force does not require taxpayers to quantify the tax liability in a currency rather than in another one. Nor it exists a tax rule that defines which currency is to be qualified as *foreign currency* and which one as *non-foreign currency*. This may lead to absurdly think that the corporate income tax provisions would be applicable also in case the currency used is a currency other than Euro.

[90] For a discussion on this issue see the following authors: DOMINICI R., *Le operazioni in valuta*, in TESAURO F. (a cura di), *Imposta sul reddito delle società (IRES)*, Bologna, 2007, p. 990; CASSANDRO P.E., *La valutazione delle attività e delle passività espresse in moneta estera*, in AA.VV., *Studi in onore di Ugo Caprara*, Milano, 1975, II; ROSSI RAGAZZI F., *Problemi fiscali e di bilancio delle stabili organizzazioni all'estero*, in *Consulenza*, 1987, 11.

translated at year end in order to determine the taxable income (tax loss) arisen by the foreign entity. Hence, this translation process is to be performed at the end of the fiscal year and it may imply the rise of exchange differences with respect of the previous fiscal year accounts. Since these differences basically derive from the need for translating foreign accounts for the purpose of including them in the parent's financial statements – i.e. it is not a proper foreign currency conversion – they are not of a business nature and therefore they are not relevant for tax purposes[91]. This implies that, if these exchange differences are accounted for in the profit and loss statement, the parent company has to make in the relevant tax return an increasing/decreasing adjustment in order to treat them as irrelevant for corporate income tax purposes[92].

As already discussed in paragraph 7, a further important tax provision in the field of foreign currency matters is that governing the possibility for separate entities entertaining habitual relations in a foreign currency to adopt the multicurrency accounting system (article 110, paragraph 2, third sentence, of the ITC). Under this rule, single entities having habitually commercial and financial interest in different currencies are permitted to record transactions in the foreign currency in which they are regulated, without for them to be converted to the functional currency at the time the transactions are made. The purpose of this provision is to facilitate those entities in the recording proceedings, so as to reduce the administrative burden of companies.

For tax purposes, accounts held in foreign currency are converted into the home currency by using the exchange rate at year end. Any exchange

---

[91] LEO M., *Le imposte sui redditi nel Testo Unico*, Tomo II, Giuffrè, Milano, 2014, p. 2011.

[92] LEO M., *Le imposte sui redditi nel Testo Unico*, Tomo II, Giuffrè, Milano, 2014, p. 2011. See also ZIZZO G., *Regole generali sulla determinazione del reddito d'impresa*, in AA. VV., IRPEF, in *Giur. Sist. Tesauro*, II, Torino, 1994, p. 576; PIAZZA M., *Guida alla fiscalità internazionale*, Il Sole 24 Ore, Milano, 2004, p. 1215.

difference that may arise with respect to the account balances of the previous fiscal year are relevant for tax purposes[93].

[93] LEO M., *Le imposte sui redditi nel Testo Unico*, Tomo II, Giuffrè, Milano, 2014, p. 2012.

CHAPTER TWO

THE FUNCTIONAL CURRENCY CONCEPT AND THE FOREIGN CURRENCY TRANSACTIONS UNDER THE INTERNATIONAL ACCOUNTING STANDARDS

1. Introduction.

The previous chapter was primarily devoted to illustrate the financial accounting aspects of foreign currency translation and the various methodologies applicable to translate foreign currency amounts in accounting practice, as proposed by the relevant accounting literature existing in both the national and international scenario. All this material in Chapter One can act as a preparation to fully understand the approach adopted by the international accounting principles with the issuance of IAS 21 for foreign currency matters.

IAS 21 is one of the most important international accounting principles in terms of preparation of financial statements. On the one hand, it must be applied by IAS adopters in translating foreign currency transactions and balances. On the other hand, it must be enforced at the time a foreign entity, such as a foreign subsidiary, joint venture and associate, is set up in order to include its accounts in the consolidated statements.

The translation rules set by IAS 21 are based on the functional currency concept. As explained more fully in the rest of this chapter, under this concept an entity has to adopt in accounting the currency of the primary economic environment in which it operates and generates cash flows, regardless of that adopted in the country where the entity is established. The functional currency approach is of significant relevance for financial reporting because its designation determines the choice of translation method employed both for consolidation and individual purposes and has direct influence on the recognition of exchange gains and losses in financial statements.

As described in the next sections, the notion of functional currency and its effects on translation methodologies was introduced by the IASB to achieve convergence with the US GAAP, where the relevant notion was included in FAS 52 (now ASC830). However, to date, no convergence exists between IAS/IFRS (and US GAAP) and the Italian GAAP as an exact equivalent of the notion of functional currency does not exist in the Italian accounting terminology and regulations. That is, under Italian GAAP the sole currency to be adopted for keeping the books of accounts and for financial statements purposes is the euro.

This chapter examines, broadly and comparative, the foreign currency translation approach required by IAS 21, providing evidence of the significant role played by the notion of functional currency and its identification criteria in financial performance, as set forth by IAS 21.

It is beyond the scope of this chapter an analysis of the functional currency in the context of a hyperinflationary economy, as the matter is governed by provisions stated by IAS 29 – *Financial Reporting in Hyperinflationary Economies* and not by IAS 21.

2. Development of an International standard on foreign currency matters: background of IAS 21.

The existing diversity of accounting practice and rules around the world gave rise to great difficulties in the preparation of an international standard on foreign currency translation[94].

The original standard was issued by the IASC in July 1983 and was named IAS 21 – *Accounting for the effects of changes in foreign exchange rates*[95].

This version of the standard was built on an approach to translation that varied in relation to the cash flow consequences of the exchange rate movements. In particular, the two principal ideas were that (i) exchange differences which gave rise to cash flows, i.e. those resulting from business transactions, were reported as part of the profit or loss for the period, and (ii) other exchange differences which did not give rise to cash flows, because they resulted from retranslations of the parent company's long-term investment in foreign subsidiaries, were reported as reserve movements. As to this second case, the method of translating the foreign entity's accounts into the consolidated financial statements depended on how that foreign entity was classified for the purpose of IAS 21.

In particular, the original version of the IAS 21 classified the foreign operations in two separate categories:

1. the "foreign entities", that were entities with a significant degree of autonomy in the view of the parent entity; for these entities, any difference in the exchange rate between the currency locally adopted by the foreign entity and the currency of the parent entity

[94] NOBES C., PARKER R., *Comparative International Accounting*, Tenth edition, Prentice Hall, New York, 2008, p. 409.
[95] A revised version of the IAS 21 was issued in 1993 although it followed the same approach as that of the previous version.

had limited impact since it merely affected the value (recorded by the parent entity) of the net investment in the foreign operation;

2. the "foreign operations that are integral to the operations of the reporting entity" that were considered as extensions of the reporting entity; in this case, any exchange rate movements between the currency of the foreign operation and that of the parent had direct impact on the financial items of the holding company[96].

Where a foreign operation was classified as "foreign entity", the translation of its accounts was made at the closing rate method[97]; on the contrary, in case of "foreign operations that are integral to the operations of the reporting entity", the temporal method was used[98].

In December 2003, the IASB – the IASC's successor – issued a revised version of the IAS 21 that replaced the previous version for annual periods beginning on or after 1st January 2005.

In revising the IAS 21, the IASB's "main objective was to provide additional guidance on the translation method and on determining the functional and presentation currencies. The Board did not reconsider the fundamental approach to accounting for the effects of changes in foreign exchange rates contained in IAS 21"[99].

---

[96] ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, cited, p. 24. For a detail discussion on the differences between "foreign entities" and "integral foreign operations" existing under the previous version of IAS 21, see PARIS A., *La traduzione dei bilanci delle affiliate estere: un'indagine sullo "stato dell'arte" nei Paesi dell'Europa Occidentale*, in *Rivista Italiana di Ragioneria e di Economia Aziendale*, settembre-ottobre 1994, p. 465, 467 and 468; PARIS A., *La traduzione dei bilanci delle affiliate estere: un'indagine del divario tra principi contabili e prassi contabile verificabile nei Paesi dell'Europa Occidentale*, in *Rivista Italiana di ragioneria e di Economia Aziendale*, novembre-dicembre 1994, p. 575-577.

[97] IAS 21 (revised 1993), paras. 30-31.

[98] IAS 21 (revised 1993), paras. 27-29.

[99] IAS 21 "*The effects of changes in foreign exchange rates*" (revised 2003), par. IN3. "The International Accounting Standards Board developed this revised IAS 21 as part of its project on Improvements to International Accounting Standards. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the project were to

The main changes from the previous version were in terminology. In particular, this amended version of IAS 21 contained three key terms that are of fundamental importance to make the standard understandable. As broadly discussed in the next sections, these terms are the following:

3. the *functional currency*, which is defined as the currency of the primary economic environment in which an entity operates;
4. the *foreign currency*, which is defined as a currency other than the functional currency of the entity;
5. the *presentation currency*, which is defined as the currency in which the financial statements are presented[100].

The introduction of the functional currency concept was undoubtedly the most significant innovative aspect of the revised IAS 21: it had the merit to provide clear criteria to address companies in determining, both at the entity level and at group level, the appropriate currency to be used to account for business transactions as well as foreign investment[101].

After the revised version of IAS 21 issued in 2003, constituents raised a number of minor concerns and required that some types of exchange differences arising from a monetary item should be separately recognized as equity. As a consequence, the IASB published an Amendment to IAS 21 in December 2005[102] and therefore IAS 21 was amended accordingly[103].

It is this latest version that is analyzed in the following sections.

---

reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements" (IAS 21, revised 2003, par. IN2).

[100] NOBES C., PARKER R., *Comparative International Accounting*, Tenth edition, Prentice Hall, New York, 2008, p. 409.

[101] A direct consequence of this introduction was that the distinction between "foreign entities" and "foreign operations that are integral to the operations of the reporting entity" – as resulting from the previous version of IAS 21 – was removed and the requirements laid down that previous classification are now among the indicators to identify the functional currency of an entity (IAS 21, par. IN7). This aspect is examined in detail in par. 3 of this Chapter.

[102] Amendment to IAS 21 "*The effects of changes in foreign exchange rates – Net investment in a foreign operation*", IASB, December 2005.

[103] By Commission Regulation (EC) No. 708/2006 of 8 May 2006 the amendments to IAS 21 were adopted.

3. The functional currency approach under IAS 21

A large part of the IAS 21 deals with the definition of functional currency and provides companies with proper criteria to identify it.

As mentioned above, the functional currency concept was introduced in the revised version of the standard issued in 2003[104] and is defined as "*the currency of the primary economic environment in which the entity operates*"[105]. The economic rationale behind the introduction of this concept was the need to place more emphasis on the underlying economy that determines the pricing of transactions rather than on the currency in which those transactions are denominated[106].

IAS 21 defines the *primary economic environment* in which an entity operates as "*normally the one in which it primarily generates and expends cash*"[107]. It is clear that under normal circumstances, the functional currency for the majority of entities is the currency of the country in which they are based and carry on their business. However, IAS 21 leaves open the possibility that the functional currency of an entity may not be that of the country in which

[104] The original version of IAS 21 contained the sole concept of "reporting currency" that was defined as the "currency used in presenting the financial statements". As clarified by the IASB's Basis for Conclusions on implementing IAS 21 (par. BC4), this definition comprises two separate notions, such as the "measurement currency" (that is the currency in which the entity measures the items in the financial statements) and the presentation currency (the currency in which the entity presents its financial statements). Prior to the revision of IAS 21 occurred in 2003, the concept of functional currency was contained in SIC-19 *Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*, although it was not expressly named as functional currency. Under SIC-19, the currency an enterprise uses in measuring items in its financial statements should be selected to provide information about the enterprise that is useful and reflects the economic substance of the underlying events and circumstances relevant to that enterprise; all other currencies are treated as foreign currencies in the measurement of items in the financial statements and translation of financial statements. The SIC-19 was superseded by IAS 21 (revised 2003), effective for annual periods beginning on or after 1st January 2005. IAS 21 gives greater emphasis than SIC-19 gave to the currency of the economy that determines the pricing of transactions, as opposed to that in which transactions are denominated (IAS 21, par. IN7).

[105] IAS 21, par. 8.

[106] Basis for Conclusions on implementing IAS 21 (par. BC5).

[107] IAS 21, par. 9.

it is based[108]. This would occur where the entity's revenues and costs are mainly influenced by another country or by the type of business they carry on and by that other country or business's currency[109].

Thus, in the view of IAS 21, the functional currency that an entity should adopt does not depend on the geographic localization but, rather, it should represent the currency of the primary economic environment in which the companies operate[110].

To assist in determining the functional currency and to be sure that the choice is not arbitrary, IAS 21 set the indicators to be considered, both individually and collectively, in the identification of an entity's functional currency[111].

Five economic factors can be taken into account in defining the entity's functional currency[112]. Hence, the functional currency is identified as follows:

1. the currency that mainly influences the price at which goods and services are sold, namely the currency in which sales prices for its goods and services are denominated and settled;
2. the currency of the country whose competitive forces and regulations mainly influence the entity's pricing structure[113];

---

[108] NOBES C., PARKER R., *Comparative International Accounting*, cited, p. 409.
[109] It is the case, for example, of companies operating in the oil and gas industry, where oil is priced and traded in USD and therefore contracts and transactions for the sale of oil are normally denominated in USD.
[110] COMOLI M., CORNO F., VIGANÒ A. (a cura di), *Il bilancio secondo gli IAS*, Giuffrè, Milano, 2006, p. 539.
[111] COMOLI M., CORNO F., VIGANÒ A. (a cura di), *Il bilancio secondo gli IAS*, cit., p. 540.
[112] IAS 21, paras from 9 to 14.
[113] The currencies under points nos. 1 and 2 are also known as currencies that have influence on the entity's proceeds. See DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, IPSOA, Milano, 2012, p. 820. This the case, for example, of an Italian entity that has as its main business activities the sale of goods where the selling price is fixed in dollars and therefore most of its sale invoices are issued in that currency, regardless of what nationality its clients are. The reasons for this may be, for instance, that those prices are listed on regulated capital markets or that all major competitors have prices denominated in dollars. In this case, based on the analysis of the factors in IAS 21, the Italian entity's functional currency would be the USD. This implies that the Italian entity's accounting records would be first remeasured into USD (its functional currency) in relation to all transactions denominated in a currency other than

3. the currency that influences the costs of the entity, such as labour, material and other costs of providing goods and services[114];
4. the currency in which funds from financing activities are generated;
5. the currency in which receipts from operating activities are retained.

The IASB suggests a hierarchy among these factors, providing that the first three items are generally considered to be the most influential in determining the functional currency of an entity[115].

It may happen that the above economic indicators are mixed and the definition of the functional currency is not so obvious: in these cases, the selection of the functional currency is a matter of management's judgment. In fact, it is the management that is in the best position to determine which currency most faithfully represents the economic effects of the underlying transactions, events and conditions[116].

The table below provides a summary of the approach required by IAS 21 to determine the function currency to be adopted by single entities[117].

USD and then translated to EUR (the currency used to present the financial statements under Italian law).

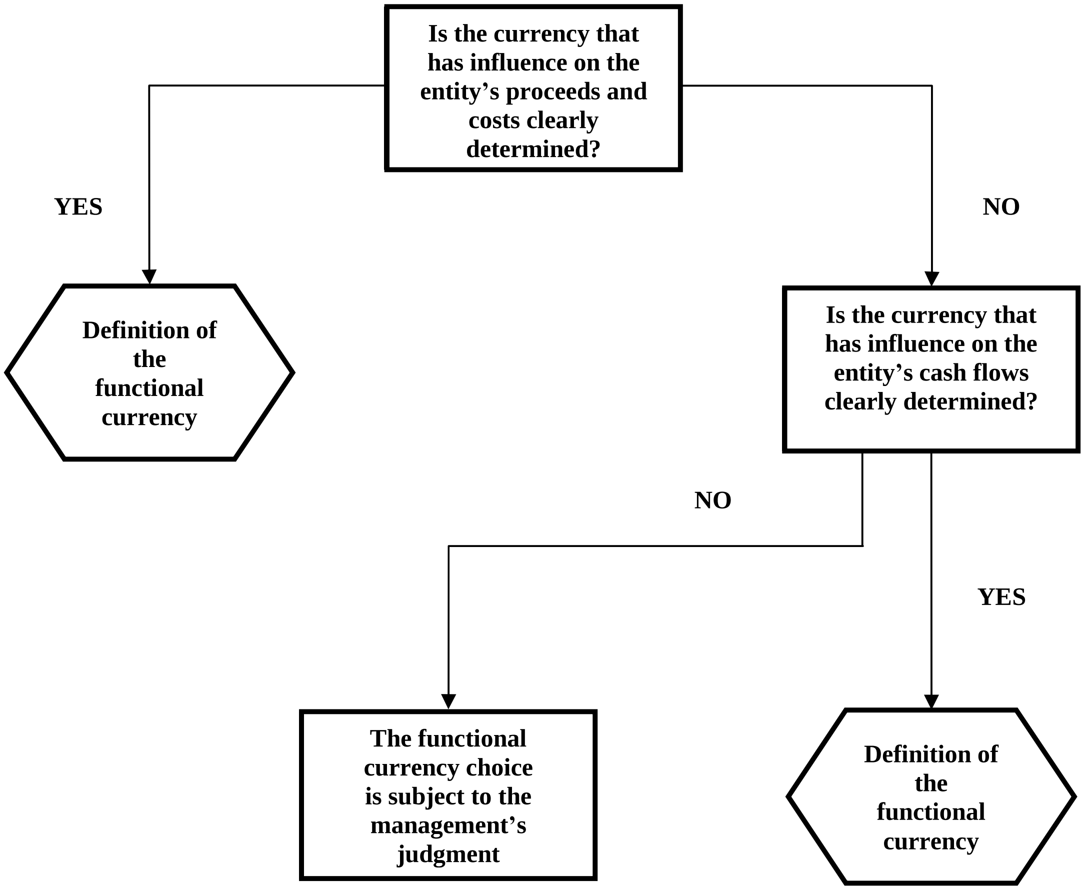
[114] This currency is also defined as the currency that influences costs and is normally referred to the currency in which expenses for labour, material and other costs born for the provision of goods and services are denominated. See DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, cited, p. 820.

[115] See Basis for Conclusions on implementing IAS 21, par. BC9. On this issue, see also MIRZA, A. A., ORELL, M., HOLT, G. J., *IFRS: Practical Implementation Guide and Work Book*, cited, p. 159 and COMOLI M., CORNO F., VIGANÒ A. (a cura di), *Il bilancio secondo gli IAS*, cited, p. 541.

[116] IAS 21, par. 12. In this cited section, it is also stated that for the purpose of the functional currency designation, the management should give priority to the primary indicators illustrated in previous points from 1 to 3 and subsequently consider those under points 4 and 5, which are designed to provide additional supporting evidence to determine an entity's functional currency.

[117] It should be noted that the identification of the function currency needs to be assessed by each single entity for the purpose of preparing its separate financial statements. IAS 21 does not require the identification of a unique functional currency at group level. This emerges from the Basis for Conclusions on implementing IAS 21 (par. BC19) where it is observed that "this method avoids the need to decide the currency in which to express the financial statements of a multinational group before they are translated into the presentation currency. As noted above,

Table 1. Flowchart summary of the identification of the functional currency under IAS 21 for stand-alone and parent entities.



Source: Adapted by the author from IASB, International Accounting Standard 21, last update as at July 2009.

When an entity owns investment in a foreign operation – such as a subsidiary, an associate, a branch, a joint venture that is located in a country other than that of the parent entity – it is to be assessed whether the foreign operation may adopt as functional currency the same currency as that of its parent company[118]. The issue here is to assess whether or not a strong link

---

many large groups do not have a single functional currency, but comprise operations with a number of functional currencies. […]".

[118] As previously noted, in the original version of IAS 21 there was a distinction between "foreign entities" and "integral foreign operations" that implied different translation methods, such as the closing rate method in the former case and the temporal method in the latter case. In the current version of IAS 21, this distinction no longer exists and the principles for

exists in the business relation between the parent company and the investment in the foreign operation[119].

To this purpose, IAS 21 provides the following additional economic factors to be considered in those cases in which the above mentioned indicators do not lead to a clear designation of the relevant functional currency[120]:

a. the way the activities of the foreign operation are carried out (i.e. as an extension of the reporting entity or with a significant degree of autonomy);
b. what proportion of the foreign operation's transactions are with the reporting entity, and
c. the nature of the cash flows and in particular whether cash flows from the activities of the foreign operation
    i. directly affect the cash flows of the parent entity and are readily available for remittance to it, and
    ii. are sufficient to finance the same foreign operation without further funds from the parent entity.

If from the above criteria it results that the foreign entity is viewed by the parent as an autonomous entity, being relatively self-contained and integrated within the foreign country, then the local currency is its functional currency. In the opposite case, if a foreign entity is merely an extension of its parent company, its functional currency is that of the parent entity.

Table 2 charts the translation procedures described here.

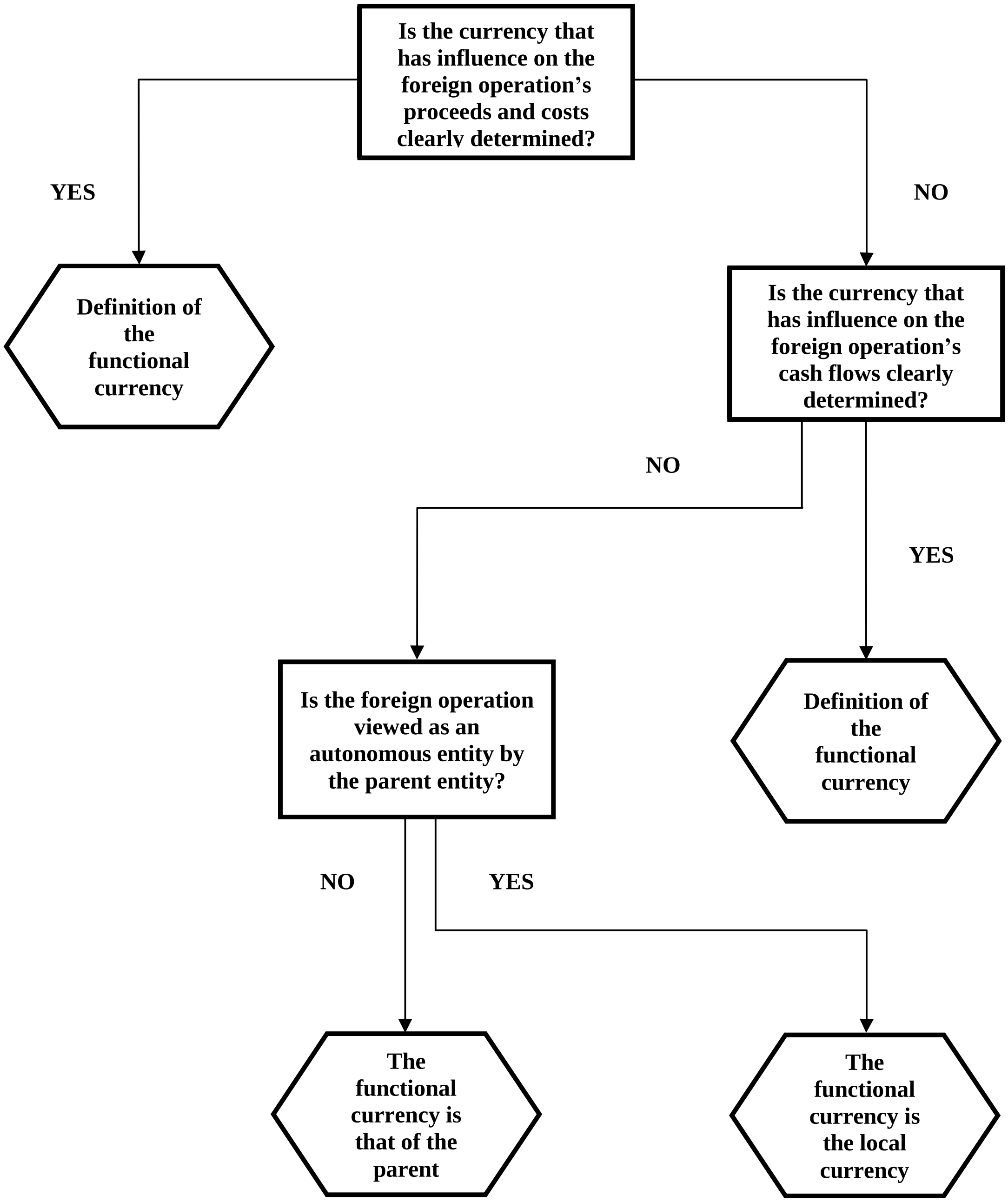
---

distinguishing a foreign entity from an integral foreign operation have been incorporated among the business indicators that have influence in determining an operation's functional currency (see Basis for Conclusions on implementing IAS 21, par. BC6, BC7 and BC8).

[119] It has been observed that where a foreign operation is deemed to be strongly connected to the parent entity, the functional currency should in principle be that of the parent entity, while in the opposite case, the foreign operation may adopt a different currency as functional currency that shall be determined in compliance with the economic indicators provided with by IAS 21. See COMOLI M., CORNO F., VIGANÒ A. (a cura di), *Il bilancio secondo gli IAS*, cited, p. 540.

[120] DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, cited, p. 821.

Table 2. Flowchart summary of the identification of a foreign operation's functional currency under IAS 21.



Source: Adapted by the author from IASB, International Accounting Standard 21, last update as at July 2009.

Since the entity's functional currency reflects the transactions, events, and conditions under which the entity conducts its business, once it is decided on, IAS 21 requires that it does not change unless there is a change in the underlying nature of the transactions and relevant conditions and events.

4. The functional currency concept under US GAAP: a comparison with IAS 21

IAS 21 was clearly based on FAS 52 – *Foreign currency translation*[121] (now codified in ASC 830), the U.S. authoritative pronouncement on accounting for foreign currency, and followed it on the basic approach to foreign exchange translation[122].

In particular, both FAS 52 and the current version of IAS 21 seek to

1. reflect, in consolidated statements, the financial results and relationships measured in the primary currency in which each consolidated entity does business (its functional currency);

[121] FAS 52 was introduced in December 1981 to revise the translation rules previously included in FAS 8 – *Accounting for the translation of foreign currency transactions and foreign currency financial statements*, issued in 1975 and effective from 1976 to 1981. From its inception, FAS 8 was a rather controversial standard. In particular, it required the remeasurement of assets and liabilities denominated in foreign currency into dollars by applying the appropriate temporal exchange rate associated with each items, with the translation gain and loss reported directly in the income statement during the period of rate change. Due to this combination of temporal translation and income reporting, "FAS 8 was criticized by managers and practitioners for introducing artificial volatility into reported earnings and for producing currency adjustments that often were opposite in direction to the economic effect of exchange rate changes on the value of foreign operations" (BARTOV E., BODNAR G. M., *Foreign Currency Translation Reporting and the Exchange-Rate Exposure Effect*, in *Journal of International Financial Management and Accounting*, 1995, vol. 6, 2, p. 94). This criticism of FAS 8 caused the FASB to restudy the matter and led to the issuance of FAS 52 in late 1981 whose main innovative aspect was the concept of a "functional currency". In March 2013, FASB issued the ASC Topic 830 on foreign currency matters to provide guidance on foreign currency measurements and translations.

[122] See SAUDAGARAN, SHAHROKH M., *International Accounting: A User Perspective*, 2nd edition, Thompson South-Western, 2004; NOBES C., PARKER R., *Comparative International Accounting*, cited, p. 409.

2. provide information that is generally compatible with the expected economic effects of an exchange rate change on an enterprise's cash flows and equity.

These objectives are based on a functional currency translation approach, that is the most important similarity between IAS 21 and FAS 52. Determining the functional currency of an entity is an important procedure for both IAS and US GAAP because remeasurement and translation provisions[123] are both based on the choice of the functional currency.

Under FAS 52, an entity's functional currency is defined as the currency of the primary economic environment in which the operations and the cash flows are domiciled[124]. The basic approach of FAS 52 is not to impose the use of a single currency for entities and groups but rather it establishes a situational concept of functional currency determination that is based on a local perspective[125].

FAS 52 places reliance on management judgment in the functional currency designation and provides a list of six economic indicators to be considered both individually and collectively when determining the functional currency[126]. In particular, the six economic indicators are:

1. Primary source of the entity's cash flow;

---

[123] For the sake of clarity, it should be noted that FAS 52, such as IAS 21, makes an important distinction between remeasurement and translation. In particular, remeasurement is the process of measuring in the functional currency the amounts that are denominated or stated in a currency other the functional currency. Translation is the process used for expressing the financial results of a separate entity so that it may be included in the parent entity's consolidated financial statements when the separate entity's functional currency is different from the parent's. Remeasurement affects earnings and translation affects equity of the entity. See RASHTY J., *Foreign Currency Matters. New Guidance for Derecognition of Cumulative Translation Adjustments*, in *The CPA Journal*, March 2014, p. 55.

[124] FAS 52, par. 5, now included in ASC 830-10-45-2.

[125] In other words, FAS 52 recognized that, at group level, the parent company and the foreign subsidiary perspectives are both legitimate reporting frameworks and therefore, it introduced "the shift from the parent company perspective, which is consistent with the temporal method, to the local perspective". See HOSSEINI A., SHALCHI H., *A multivariate analysis of the determinants of the functional currency dichotomy decisions*, in *Global Finance Journal*, 1992, vol.3, 1, p. 52.

[126] FAS 52, par. 42, now included in ASC 830-10-55-5.

2. Sales price sensitivity to short-term fluctuations in exchange rates;
3. Nature of the sales market for the entity's products;
4. Source of expenses;
5. Primary source of financing for the foreign entity;
6. The volume of intercompany transactions and arrangements.

More in detail, the following table shows the key questions that should be addressed for each economic indicator to determine the functional currency of an entity[127]:

Table 3. Functional currency criteria

Indicators under FAS 52 (now ASC 830)	**Questions**
1. Primary source of the entity's cash flow	(i) are cash flows related to the foreign entity's assets and liabilities primarily in the foreign currency? (ii) are these cash flows independent from those of the parent entity?
2. Sales price sensitivity to short-term fluctuations in exchange rates	(i) are the sale of prices of the foreign entity's products determined by local market condition rather than influenced by changes in exchange rates?
3. Nature of the sales market for the entity's products	(i) is there an active local sales market for the foreign entity's products?
4. Source of expenses	(i) are labour, materials and other costs for the foreign entity's products local rather than imported from the parent company?
5. Primary source of financing for the foreign entity	(i) is the foreign entity's primary financing in terms of the functional currency?
6. The volume of intercompany transactions and arrangements	(i) is there a law volume of of intercompany transactions between the entity and its parent company?

Source: Adapted by the author from IASB, International Accounting Standard 21, last update as at July 2009.

127 See RATCLIFFE T.A., MUNTER P., *Currency translation: a new blueprint*, in *Journal of Accountancy*, June 1982, p. 83.

If the majority of the answers to the above questions is yes, the entity should adopt its local currency as functional currency; in the opposite case, the functional currency would be that used by the parent entity[128].

FAS 52 (now ASC 830) does not weight or rank the above mentioned indicators. This leads to complications when several of the indicators point to the foreign currency as the functional currency while other indicators point to the local currency. In these cases, the FASB allows management latitude in selecting the functional currency and thus in evaluating the specific facts and circumstances to determine which indicators are the most relevant to the distinct and separable operation and the economic environment in which an entity operates[129].

In this sense, both FAS 52 and IAS 21 permit to choose between two different accounting methods – either the temporal method (i.e. the parent currency as functional currency) or the current rate method (i.e. the foreign/local currency as functional currency) – for measuring and reporting the impact of exchange rate difference on foreign operations. This choice is a function of the functional currency selected by firms to account for business transactions and foreign operations.

---

[128] "One would choose the foreign local currency as the functional currency if a foreign subsidiary's operation is basically self-contained and integrated within the foreign country with infrequent inter-company transactions with the parent company; and cash flows are primarily in the local currency and do not impact parent's cash flows, sales price are largely unresponsive to exchange rate changes, sales market is largely in the host country and denominated in the local currency, expenses incurred primarily in the local environment, and financing is primarily denominated in local currency and serviced by local operation. And one would choose the parent company's currency as functional currency when the situation reverses as when there is frequent and extensive inter-company transactions, cash flows are directly remitted to the parent, sales market is largely in the parent country, and denominated in parents currency and financing from the parent company or reliance on the parent for servicing debt obligation" CANTORIA F.M., *Consolidation of foreign subsidiaries: revisiting SFAS 52*, in *Academy of Accounting and Financial Studies Journal*, 2011, vol. 15, Special Issue, 2, p. 46.

[129] This leeway is explicitly stated in FAS No. 52, where it is stated that "Management is in the best position to obtain the pertinent facts and weigh their relative importance in determining the functional currency for each operation. It is important to recognize that management's judgment is essential and paramount in this determination, provided only that it is not contradicted by the facts" (FAS 52, paragraph 41).

While there is a massive foreign currency translation literature on FAS 52 and its predecessor FAS 8[130], few empirical researches exist that test how managers determine functional currencies and what factors are used in such decisions. Among these latter researches, results showed that the relative weights (importance) placed by firms on these six factors vary considerably, and that four of the six indicators – such as the sales market, volume of intercompany transactions, cash flow and sources of financing – provide significant predictive ability in classifying the functional currency designations[131].

Although today research is inconclusive and uncovered by empirical studies, there is a vast accounting literature – mostly in the US accounting scenario – that considers whether managers act opportunistically when choosing the functional currency, thus manipulating income and other financial statements amounts. These issues are examined in the rest of this chapter (see paragraph 7).

In this regard, it is important to realise that preparers of financial statements have to contend with the need for *neutrality* that laid down in both

[130] In the US accounting literature on foreign currency translation, there are a number of studies that investigate whether or not the use of different functional currencies affects the quality of earnings of US based multinational corporations. These researches stem from a concern that the choice of the functional currency affects the translation method to be used and the presentation of foreign exchange adjustment (gains or losses) in the financial statements. For a discussion on this issue, see POLI P.M.., *Functional currency: effects on earnings and the market*, in *Journal of International Business Studies*, 1996, vol. 27, 2, p. 436; BARTOV E., BODNAR G. M., *Foreign Currency Translation Reporting and the Exchange-Rate Exposure Effect*, in *Journal of International Financial Management and Accounting*, 1995, vol. 6, 2; GRAY D., *Corporate Preferences for Foreign Currency Accounting Standards*, in *Journal of Accounting Research*, 1984, vol. 22, 2, p. 760; TANG R.T.W., *Foreign currency translation information reported by Fortune 500 companies*, in *Journal of Corporate Accounting and Finance*, Spring 1995, vol. 6, p. 67.

[131] See HOSSEINI A., SHALCHI H., *A multivariate analysis of the determinants of the functional currency dichotomy decisions*, cited, p. 63, where it was concluded that "the economic indicators outlined in FAS no. 52 have strong explanatory power and are highly correlated with and are systematically used in the firm's functional currency choice decisions". Moreover, it has been recently recognized that "sales price, sales market, and expense indicators are the most important factors in determining the primary economic environment in which a distinct and separable operation operates. Cash flows can also be an important indicator provided the cash flows are not merely an invoicing or settlement currency, but reflect the underlying transactions' economics." See PWC, *Foreign currency*, 2014, p. 3-3.

IAS/IFRS and US GAAP. In fact, the IASB and FASB have always recognized the desirability of avoiding a bias in the preparation of financial statements, which is why neutrality is included in the IASB's conceptual framework as a feature of useful and reliable information[132]. The author's view is that neutrality should act as a necessary check on the optimism of management, which is always trying to present the results of its endeavours in the best possible light.

In this sense, the basic approach adopted by the IASB in the field of foreign currency matters – and better detailed in the rest of the chapter – is to apply the closing rate method and thus to value monetary assets and liabilities at the closing rate, but to defer the transfer of any gain to the income statement (i.e. to the 'profit and loss' part of comprehensive income) until the foreign currency asset/liability is realized.

5. The foreign currency, the presentation currency and the methods for translating

Having looked at the criteria set forth by IAS 21 for the designation of an entity's functional currency, it may be useful to examine the significant impacts that the functional currency approach have on both the accounting for foreign currency transactions and the preparation of financial statements for single entities and for group perspectives. In principle, once the functional currency is defined, IAS 21 requires translation of foreign currency transactions and translation of foreign operations' financial statements in two different cases:

(i) when preparing the stand-alone entity's financial statements in the functional currency, and

[132] Under the principle of neutrality, information needs to be free from bias: it is regarded as a necessary component of providing a faithful representation of the underlying economics.

(ii) when presenting the (separate and consolidated) financial statements in a currency other than the functional currency[133].

Under case (i), entities entering into transactions that are denominated in a currency other than their functional currency (so called *foreign currency*) need to translate those foreign currency items into their functional currency and report the effects of such translation in accordance with the provision of IAS 21[134].

The translation under case (ii) exists because IAS 21 allows companies to present their financial statements in any currency (so called *presentation currency*), and therefore even by using a currency that is not the functional one. In these cases, entities are required to translate their accounts and financial position from it functional currency into the presentation currency[135].

To facilitate the understanding of the approach required by IAS 21 in the aforementioned cases, a separate examination of the existing translation procedures is illustrated in the following paragraphs.

5.1. Translation of foreign currency transactions into the functional currency

From the single entity's point of view, foreign currency transactions – denominated in a currency other than the entity's functional currency – should

[133] ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, cited, pag. 26.
[134] In this regard, it is necessary to recall that IAS 21 defines the *foreign currency* as "a currency other than the functional currency of the entity" (IAS 21, par. 8). The approach required by IAS 21 to translate foreign currency transactions into the functional currency is discussed in IAS 21, par. 20 to 37, as better described in next sections.
[135] "It is necessary for the results and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies)". See COMMISSION REGULATION (EC) No 2238/2004 of 29 December 2004, International Accounting Standard 21, par. 18.

be remeasured in another currency, its functional currency, that is the currency in which its books are normally kept.

To this purpose, IAS 21 mandates the following treatment for foreign currency transactions:

1. At the date the transaction is recognized, each asset, liability, revenue, expense, gain, or loss arising from the transaction shall be measured and recorded in the functional currency of the recording entity by using the exchange rate in effect at that date: this translation is termed by IAS 21 as *initial recognition*[136].

2. At each balance sheet date, recorded balances that are denominated in a currency other than the functional currency shall be adjusted to reflect the current exchange rate, by applying the following criteria[137]:

a) foreign currency *monetary* items shall be translated using the closing rate;
b) *non-monetary* items that are measured in terms of historical cost in a foreign currency shall be translated at the historical exchange rate, i.e. the rate in effect when the asset was purchased or the liability incurred; and
c) *non-monetary* items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was measured.

On this basis, a foreign exchange adjustment (i.e., gain or loss on a settled transaction) is necessary whenever the exchange rate changes between the transaction date and the settlement date. Where financial statements are

[136] However, for practical reasons, IAS 21 (paragraph 22) allows companies to use a rate that approximates the actual rate at the date of the transaction. For example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate. In fact, the use of an average rate for all the transactions occurred in a certain period, would lead to unreliable results. However, IAS 21does not identify any threshold for a rate to be deemed to be subject to a significant fluctuation. See DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, cited, p. 836-837.
[137] IAS 21, paragraph 23.

prepared before the transaction is settled, the accounting adjustment (i.e., gain or loss on an unsettled transaction) will equal the difference between the amount originally recorded and the amount presented in the financial statements.

In general, in this situation, a translation gain or loss arises only in respect of monetary assets, since non-monetary assets will normally be valued on the basis of the historical rate. Under IAS 21, these exchange differences should be reflected as part of the entity's profit and loss statement (temporal method)[138] and shall continue to be included in profit and loss in consolidated statements[139].

Moreover, the translation procedure at hand is also applicable to those entities that keep (or are required to keep) their records and accounts in a currency (normally, the local currency) that is different from its functional currency[140]. In this situation, the entity's accounts are remeasured from the local currency into the functional currency (temporal method) by applying the aforementioned conversion criteria (as per previous point b.) so that all

[138] IAS 21, paragraph 28.

[139] This is because the monetary item represents a commitment to convert one currency into another currency and exposes the parent entity to a gain or loss through currency fluctuations. For the sake of completeness, it should be noted that an exception to this principle (i.e. translation adjustments recognized in the net income) exists when an exchange difference arises on an intra-group balance that forms part of an entity's net investment in a foreign operations in the specific case of monetary items for which settlement is neither planned nor it is likely to occur in the foreseeable future (as defined by IAS 21, paragraph 15). In fact, in this case foreign currency transactions are translated, by each entity individually, in accordance with the translation procedure above described and the exchange differences arising on monetary items that form part of the reporting entity's net investment in a foreign operation are recognized in the consolidated financial statements within a separate component of equity, called *Other Comprehensive Income*. These exchange differences are maintained as a component of the consolidated net equity and shall be recognized in profit or loss upon disposal of the net investment, as stated by IAS 21, par. 48.

[140] This is the case where there is no coincidence between the functional currency (defined under the criteria set forth by IAS 21) and the currency adopted by the entity to keep its books of account.

balances items are remeasured as if they were recorded initially in the functional currency[141].

5.2. Translation when the presentation currency differs from the functional currency

As previously mentioned, IAS 21 permits entities to present their financial statements in any currency[142]. This leads to situations where the presentation currency may differ from the functional currency and therefore there is the need to translate the entity's results and financial position (expressed in the functional currency) into the presentation currency[143].

To this purpose, IAS 21 provides for a translation procedure that applies to both stand-alone entities and foreign operations for inclusion in the consolidated financial statements[144].

Under IAS 21, when the functional currency is not that of a hyperinflationary economy[145], the separate entity should translate its results

[141] This point is covered by IAS 21, par. 34, which prescribes rules for this process that are essentially the temporal method. Hence, one can summarize that the temporal method is used to translate foreign accounts (generally from the currency in which the entity keeps its books of account) into the functional currency. On this issue, see DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, cited, p. 862.

[142] IAS 21, par. 38. As noted, many large groups comprise a number of entities having their local currency as functional currency. For such entities, there is the need to express their accounts in a common currency so that consolidated financial statements may be presented (IAS 21, par. 18).

[143] Italian entities must prepare the financial statements of a single entity and the consolidated financial statements in Euro units (see Article 5, paragraph 2, of the Legislative Decree no. 38 of 28 February 2005, for IAS adopters).

[144] IAS 21, paragraphs IN12-IN13. Moreover, the procedure applies not only to the inclusion of foreign subsidiaries' accounts in the consolidated financial statements but also to the incorporation of the results of associates and joint agreement and when the results of a foreign branch are to be included in the stand-alone entity preparing financial statements. See IAS 21, paragraphs 44-45.

[145] In this section, it is merely considered the case where the entity's functional currency is not that of a hyperinflationary economy. As noted, the present study does not cover the case of translation in case of currencies of a hyperinflationary economy, whose procedure is governed by IAS 29 *Financial Reporting in Hyperinflationary Economies*.

and accounts into a different presentation currency using the following procedure[146]:

d. assets and liabilities for each statement of financial year position presented (i.e. including comparatives) are translated at the closing rate;
e. income and expenses for each statement presenting profit or loss and other comprehensive income (i.e. including comparatives) are translated by applying the exchange rates at the date of transaction (or the annual average rate, as long as such rate is not subject to significant fluctuations[147])[148].

Following said translation, an exchange difference arises from the translation of the values from the functional currency into the presentation currency which, according to IAS 21, shall be recognised in "*Other Comprehensive Income*" ("OCI").

This exchange difference is comprised of two parts[149]:

1. an exchange difference that derives from translating income and expenses at the dates of the transactions (or at the average rate for the period) and assets and liabilities at the closing rate;
2. an exchange difference that derives from translating the opening net assets at the a closing rate that differs from the previous closing rate.

It should be noted that IAS 21 does not prescribe the exchange rate to be applied to translate the net equity items (other than profits and losses for the period), such as capital share and other reserves. In general terms, these items could be translated either at the closing rate or at the historical rate.

[146] IAS 21, par. 39 and subsequent ones.
[147] IAS 21, par. 40.
[148] The translation procedure applies also to the records relating to the previous year financial statements, inserted for comparative purposes. In this sense, assets and liabilities presented for the previous year balance sheet are translated at the closing rate for that previous year and the income and expenses are translated at the average rate of the previous period.
[149] IAS 21, paragraph 41, lett. a) and b).

International literature[150] supports the view that net equity items should be translated at the historical rate as this is the approach followed by the current rate method. Moreover, it is merely through the application of an historical rate that the exchange difference under point 2. mentioned above (and stated by IAS 21, paragraph 41.b) arises. On these grounds, it could be concluded that the historical rate should be applied to items of the net equity (other than profits and losses)[151].

The following table summarizes the translation criteria set forth by IAS 21 per each accounting item, for current and comparative periods.

Table 4. Presentation currency translation criteria

Accounting Items	**Current period**	**Comparative period**
Assets	Closing rate	Closing rate of the previous year
Liabilities	Closing rate	Closing rate of the previous year
Equity items	Not specified (historical rate or closing rate)	Not specified (historical rate or closing rate for the previous year)
Income/expenses (including those recognized in other comprehensive income)	Exchange rate at the date of transaction (or average rate for the period, where applicable)	Exchange rate at the date of transaction (or average rate for the previous period, where applicable)
Exchange difference (or reserve)	Separate component of equity	Separate component of equity

Source: Adapted by the author from IASB, International Accounting Standard 21, last update as at July 2009.

The above described procedure is, in substance, that of the current rate method according to which translation gains (losses) do not flow through net income but are instead reported directly as an addition to (subtraction from)

150 For a discussion on this, see EPSTEIN B.J, JERMAKOWICZ E.K, *IFRS 2007 – Interpretation and Application of Infernational Financial Reporting Standard*, Wiley, Hoboken, USA, 2007, p. 816 and subsequents; ALFREDSON K., LEO K., PICKER R., PATER P., RADFORD J., *Applying International Accounting Standards*, Wiley Australia, Milton, Australia, 2005, p. 900 and subsequent ones.
151 For a detailed discussion on this topic, see DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, cited, p. 868-869.

stockholders' equity[152]. Translation adjustments under the current rate method arise whenever

i. assets and liabilities are translated at a current rate (closing rate) that differs from that used to translate income and expenses (transaction rate or average rate for the period), and
ii. opening net assets are translated at the a closing rate that differs from the previous closing rate.

For the translation of income and expenses, as for the translation of assets and liabilities, the IASB followed closely the US GAAP. In particular, FAS 52 (now ASC 830) requires that for consolidation purposes, the financial statements of a foreign subsidiary be translated into the parent entity's functional currency, and any gains and losses due to this translation be reflected in OCI in the equity section of the parent company[153].

IASB stated that the reason why these exchange difference are recorded in the net equity, and not in the income of the period, is that the changes in exchange rates have limited or no direct impact on the present and future cash flows from operations[154].

This is the case where the exchanges differences arise from the translation from the functional currency into the presentation currency for the purpose of preparing the separate financial statements of an entity: in this case, in fact, such differences will not be accrued as income/loss[155]. In the opposite

---

[152] The reason that the IASB gives for preferring this method over the method of translating all amounts (income statement items and balance sheet items) at the closing rate is illustrated in BC17-BC19.
[153] In this case, the translation procedure under US GAAP is the same as that of IAS 21, as the assets and liabilities of a foreign subsidiary are translated at the exchange rate prevailing at the balance sheet date and revenues and expenses are translated at the exchange rate that exists when these items are recognized (or at the average of the period, if applicable). This procedure contrasts with the procedure of translating foreign currency accounts (so called remeasurement), which reflects any exchange rate fluctuations in foreign-currency denominated accounts in earnings (temporal method).
[154] IAS 21, par. 41.
[155] In this regard, it was noted that when the described procedure is used to translate books and accounts of a stand-alone entity from the functional to the presentation currency, it is not clear whether and when the exchange difference would affect the income of that entity. In this case,

case in which the procedure at hand is applied to the translation of the values of a foreign operation (foreign subsidiary, foreign associate, foreign joint venture) into the presentation currency of the consolidated financial statements, the differences would affect the income/loss (and the financial flows) in the year of the disposal of the foreign operation itself[156].

The application of this translating process is illustrated in the example reported in Appendix A.

6. Foreign currency exchange gains and losses

As explained in previous sections, translation gains and losses of a stand-alone entity can arise in respect of both translation of foreign currency transactions into the functional currency and translation of functional currency accounts into the presentation currency (where different).

In the first case, accounts generally agree that such gain or loss should be reported immediately as profit or loss in the income statement. This is the position of both the IASB and the US GAAP that are in accord on the reporting of this difference as part of profit and loss[157]. In contrast, under Italian GAAP, a translation gain on unsettled (or unrealized) transactions is to be deferred and transferred to income when settled[158].

In the second case, when considering the exchange gains and losses arising in the translation procedure from the functional currency into the

---

this exchange difference should be transferred to the income statement only when the entity is partially disposed. See DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, cited, p. 867.

[156] In this case, in fact, the price of the disposal of the foreign operation would necessarily take into account the functional currency of the foreign operation and, thus, it would be affected by the exchange differences dealt with above. As previously highlighted, on disposal of a foreign operation, the cumulative amount of exchange differences relating to that foreign operation are reclassified from equity and included in determining the profit or loss arising on disposal (see IAS 21, par. 48).

[157] This rule is subject to a number of exceptions, of which two are of particular importance: hedging and fixed assets financed through a foreign currency loan.

[158] Italian GAAP no. 26 (last version dated August 2014), paras. 42-46.

presentation currency, the approach of both the IASB and the US GAAP has been to exclude such gains and losses from the income statement. These gains and losses are referred to as “translation adjustments” in FAS 52 (now ASC 830) and as “exchange differences” in IAS 21. In particular, both FAS 52 and IAS 21 specify that the gain or loss arising on translation under the current rate method should be treated as other comprehensive income. One of the main reasons why both FAS 52 and IAS 21 exclude translation gains and losses from the income statement is the belief of those who drew up these standards that these amounts are not ‘real’ gains and losses but rather a difference thrown up by the translation process[159].

As explained in Section 5.2, the exchange differences (or translation adjustments) resulting from the process of translating an entity’s accounts from its functional currency into the single entity’s presentation currency derives from the application of the translation criteria set forth by IAS 21 (current rate method). From a mechanical viewpoint, this adjustment is an amount necessary to balance a translated entity’s trial balance. It is in fact a balancing amount necessary to satisfy the balance sheet equation and for the current period, it may be calculated directly as follows:

1. the difference between the income and expenses translated at the dates of the transactions (or at the average rate for the period) and the assets and liabilities (excluding capital transactions) translated at the closing rate, plus (minus);

[159] The nature of this translation gain and loss is dealt with in paragraphs 112–115 of FAS 52 where it is stated that there are two views that both exclude these adjustments from net income and include them in equity. Briefly, the first view is that “the translation adjustment reflects an economic effect of exchange rate changes. […] an unrealized component of comprehensive income that, […], should be reported separately from net income”. The second view is that the translation adjustment is “merely a mechanical by-product of the translation process, a process that is essential to providing aggregated information about a consolidated enterprise”. The IASB sets out a correspondent reason in IAS 21, par. 41.

2. the increase (decrease) in net assets as a result of translating the opening net assets at the a closing rate that differs from the previous closing rate.

After the first year of operation, the annual translation adjustments will be accumulated over the future years and presented as a component of equity.

It must be noted that translation differences do not exist in terms of the functional currency (i.e. in the books of accounts of an entity) as they merely arise when the translation procedure is applied for presenting the annual financial statements.

Although translation adjustments must be recorded in the equity (i.e. with no immediate effect on reported earnings), they may ultimately affect income when there is a partial or complete sale or complete or substantially complete liquidation of the investment in the foreign entity. In fact, both IAS 21 or FAS 52 specify that when a foreign entity is sold, the cumulative amount of translation gain or loss relating to it should be transferred out of the separate component of equity into the income statement, being reported as part of the gain or loss on liquidation[160].

In this regard, it must be emphasized that the accounting of exchange differences as a separate component of equity and their subsequent transfer to income upon disposal is specifically dealt with in IAS 21 for the translation of foreign operations for consolidating purposes. On the contrary, when the procedure to translate functional currency accounts into the presentation currency is followed by a single entity (other than a foreign entity for inclusion in the consolidated financial statements), the nature and the reclassification from equity to profit or loss is less obvious. As IAS 21 is silent on this matter, in this case, it would be reasonable that the reclassification may solely occur on

[160] This restatement is called the “reclassification” of exchange gains or losses ruled by IAS 21, paragraphs 48-49.

the disposal event of part of the going concern, thus implying serious problems in relation to the accounting of the exchange difference[161].

7. The functional currency choice: evidence of managerial opportunism from research findings.

Having examined the selection criteria set out in IAS 21 for determining entities' functional currency and the impact that this identification has on financial statements, this paragraph analyses the existing literature and studies that focused on managerial behaviour in the context of choosing foreign currency translation accounting methods by means of the functional currency choice[162].

This literature is part of the accounting theories that documented that managers address accounting policies and choices to manage the company's earnings for personal gain[163]. In particular, management attempts to deliberately influence or manipulate reported earnings by using specific accounting methods (or changing methods), so that the firm value is maximized and, in turn, managers' compensation is inflated[164]. The rationale

---

[161] See DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, cited, p. 867. In this regards, some authors highlighted that in these situations, it would not seem appropriate for the exchange difference to be recognized in OCI as required by IAS 21 but should either be taken to retained earnings or some other reserve. See various authors, *International GAAP 2007*, Lexis-Nexis, London, 2006, p. 743.

[162] This literature falls under the more general rubric of Positive Accounting Theory, according to which managers adopt accounting policies that allow them to gain, in the view that the firm also gains. Prior research has established that managers, when given a choice between various accounting methods, will adopt financial reporting practices which maximize their expected compensation. For a review of the extant literature, see WATTS R.L., ZIMMERMAN J.L., *Positive Accounting Theory: A Ten Year Perspective*, in *The Accounting Review*, 1990, vol. 65, no. 1, p. 131-156.

[163] For the sake of clarity, earnings mean the profits of a company which is represented by the bottom line of the income statement and a summary item in financial statements. It is a vital item in financial statements because it represents to what extent the company engaged in value added activities.

[164] This phenomenon is also known as earnings management that occurs "when managers use judgment in financial reporting and structuring transactions to alter financial report to either

for this approach is the belief that reporting earnings can be manipulated "when firm management has the opportunity to make accounting decisions that change reported income and exploit those opportunities"[165], This is made possible because in general terms accounting for business operations requires judgment and estimates.

There are a number of researches that examine the determinants and consequences of accounting choice and the relevant various techniques that are used to manage earnings in the business entity[166]. Since the works dedicated to these issues are quite extensive, the author confines this analysis to those that have been most extensively examined in the field of foreign currency translation.

It is worth noting that in general terms, the issue of translation method choice has received limited attention in the academic literature, especially having regard to the application of the IAS/IFRS that introduced at international level the choice of functional currency. In contrast, the issue of translation practices has been widely investigated within the context of the US GAAP for many different reasons. On the one hand, in fact, U.S. corporations registered over the past decades a growing tendency to have foreign direct investments, hence facing foreign currency translation matters[167]; on the other

---

mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers." See HEALY, P. M., WAHLEN J.M., *A review of the earnings management literature and its implication for standard setting*, Harvard Working Paper, 1998. One of the methods that could be used for earnings management is using the flexibility allowed in generally accepted accounting principles (GAAP) to change reported earnings— without changing the underlying (past) cash flows (that is, usage of managerial judgment in financial reporting). This is called accounting earnings management.

[165] ROMAN L.W., *Quality of Earnings and Earnings Management*, in *Journal of AICPA*, 2009.

[166] See, among others, FIELDS D.T., LYS T.Z., VINCENT L., *Empirical research on accounting choice*, in *Journal of Accounting and Economics*, vol. 31, 2001, p. 255-307; RAHMAN M.M., MONIRUZZAMAN M., SHARIF M.J., *Techniques, Motives and Controls of Earnings Management*, in *International Journal of Information Technology and Business Management*, 29th March 2013. vol.11, no.1.

[167] "In 1997 the market value of total U.S. overseas investment exceeded $1.7 trillion (*Survey of Current Business*, July 1998). In nominal dollars, U.S. direct investment increased over 300

hand, FASB has required different exchange rate translation methodologies at different times that received the attention of the literature and as well as criticism.

An item of foreign currency translation literature is comprised of theories and opinions about the selection of foreign currency translation method.

This choice of foreign currency translation method is a function of the functional currency selected to account for the operations of both domestic and foreign entities[168]. In particular, an examination of the functional currency criteria shown in paragraphs 3 and 4 of this chapter suggests that the choice of a functional currency is not straightforward, as entity operations could satisfy opposing criteria. When choice criteria conflict and the choice can significantly affect reporting outcomes, there are opportunities for earnings management[169].

percent between 1982 and 1997. In addition, *Accounting Trends* & *Techniques* reported that the number of corporations which referenced translation adjustments in their annual reports increased from 27 percent in 1980 to 56 percent in 1995 of the six hundred firms in its annual survey" (PINTO, J.A.M., *Foreign Currency Translation Method Choice: Insights from Game Theory*, in *The Journal of Applied Business Research*, 2002, vol. 18, n. 4, p. 25). A further reason that led to a massive foreign currency translation in the U.S. is that United States standard-setting bodies have required, at different times, four different translation methodologies that have been widely criticized in the accounting theory. For a discussion on this topic and the existing literature, see HOLT P.E., *A Normative Evaluation of Translation Methodologies Based On Present Values of Future Cash Flows to Investors*, in *Southwest Business and Economics Journal*, 2013, vol. 21, p. 21-34; HOLT P.E., *The variability of earnings across foreign currency translation methodologies: an empirical comparison*, in *Southwest Business and Economics Journal*, 2006, p. 67-81; HOLT P.E., *Estimation of temporal characteristics of accounts for empirical research*, in *Advances in Business Research*, 2012, vol. 2, no. 1, p. 231-237; HOLT P.E., *Some effects of alternative foreign currency translation methodologies on two short-term liquidity ratios*, in *American Journal of Economics and Business Administration*, 2011, vol. 3, p. 645-651; HOLT P.E., *Critical elements of foreign currency translation: a worldwide informational and accounting problem*, in *American Journal of Economics and Business Administration*, 2013, vol. 5, p. 56-64; HOLT P.E., *The Fischer Black Method of Evaluating Accounting Alternatives Applied to Currency Translation Methods*, in *Advances in Business Research*, 2012, vol. 3, p. 113-119.

[168] The factors to be considered in choosing the functional currency under IAS/IFRS and US GAAP has been broadly examined, respectively, in paragraphs 3 and 4 of this chapter.

[169] In this regard, it is recalled that in principle stand-alone firms who select the local currency as the functional currency use the temporal method of translation whereas those firms selecting the foreign currency as the functional currency are required to apply the current rate method of translation.

Some evidence of managerial opportunism is shown in a study conducted by Bartov E. and Bodnar[170]. They focused on FAS 52 that permitted firms to choose between two different accounting methods – either the current rate method (i.e. foreign currency as functional currency) or the temporal method (i.e. dollar as the functional currency) – for measuring and reporting the impact of exchange rate changes on foreign operations. In their study, they address the issue of accounting choice directly by examining the impact of information asymmetry on the choice[171]. Given the accounting choice set forth by FAS 52, they argue that managers of firms with high information asymmetry attempted to reduce it through the adoption of the current rate method[172]. A reduction in information asymmetries results in lower transaction costs, higher trading volumes and increases the liquidity of firm shares in equity markets. Bartov and Bodnar's results are based on the assumption that information asymmetries are reduced at the point in time when firms switch from the temporal to the current rate method of translation[173].

Other studies empirically examine how leading corporations went about selecting a functional currency. In this regards, Arnold and Holder[174] surveyed 174 Fortune 500 companies and later directly interviewed financial executives from 22 of these firms. Again, the result from verbal responses was that corporate managers exercised substantial discretion and showed a lack of objectivity when selecting the functional currency for their foreign affiliates[175].

---

[170] BARTOV E., BODNAR G. M., *Alternative Accounting Methods, Information Asymmetry and Liquidity: Theory and Evidence*, in *The Accounting Review*, 1996, vol. 71, no. 3, p. 397-418.

[171] "Information asymmetries generally are associated with the relation between (better informed) managers and (less well informed) investors." See FIELDS D.T., LYS T.Z., VINCENT L., *Empirical research on accounting choice*, cited, p. 257.

[172] This study proves that 80 percent of the 788 firms in their study employed the current rate method whereas the remaining 20 percent utilized the temporal method. Their sample was drawn from early 1980's data.

[173] A vast literature examined the impact of accounting methodology changes on firms' financial performance, as a result of managers' changes in behavior.

[174] ARNOLD J.L., HOLDER W.W., *Impact of Statement 52 on Decisions, Financial Reports and Attitudes*, Financial Executives Research Foundation, Morristown, NJ, 1986.

[175] Some of the comments collected in this survey are hereby reported:

This study concluded that "the approaches [for selecting a functional currency] used by these companies did not involve the creation and evaluation of a structured analytical or scoring mechanism".

Further researches, although inconclusive, have been conducted to assess whether managers manipulate income (and other financial statement amounts) by the choice of functional currency[176].

Pinto[177] applied game theory to observe evidence of a degree of managerial opportunism in currency translation methods preferences. The results of his analysis was that manager tend to adopt the current rate method when managerial compensation is a function of reported accounting earnings; conversely, the temporal method is preferred when managerial compensation takes the form of stock options.

Prior empirical researchers[178] studied the preference for translation methods and found that managements do change their behavior based on managements' perceptions of how different new currency translation rules may

---

"*There has been a lot of debate; the chairman of our board finally made the decision and stated, That's the last I want to hear of that*".

"*We went at it from the perspective of trying to use the U.S. dollar wherever I could within the guidelines of SFAS No. 52. Culturally, I believe that is the right way to run a U.S. multinational company. [And] I think management can make any situation it wants come out the way it wants*".

[176] See, among others: AMERNIC J.H., GALVIN B.J.B., *Implementing the New Foreign Currency Rules in Canada and the United States: A Challenge to Professional Judgment*, in *International Journal of Accounting*, 1984, p. 165–180; EVANS T.G., DOUPNIK T.S., *Determining the Functional Currency Under Statement 52*, *Stamford*, CT: FASB, 1986, p. 11–12; MEHTA D.R., THAPA S.B., *FAS 52, Functional Currency, and the Non-Comparability of Financial Reports*, in *International Journal of Accounting*, 1991, 26, no. 2, p. 71–84; KIRSCH R.J., EVANS T.G., *The Implementation of FAS 52: Did the Foreign Currency Approach Prevail?*, in *International Journal of Accounting*, 1994, 29, no. 1, p. 20–33; and AIKEN M., ARDERN D., *Choice of Translation Methods in Financial Disclosure: A Test of Compliance with Environmental Hypotheses*, in *British Accounting Review*, 2003, 35, p. 327–348.

[177] PINTO, J.A.M., *Foreign Currency Translation Method Choice: Insights from Game Theory*, cited.

[178] See, among others, AYERS F.L., *Characteristics of firms electing early adoption of SFAS 52*, in *Journal of Accounting and Economics*, 1986, vol. 8, p. 143-158; BERG G.G., *Early versus late compliance to SFAS 52: An empirical investigation of firm characteristics and the market response*, Ph.D. Thesis, 1987, Texas A&M University; GRIFFIN P.A., *Management's preferences for FASB statement no. 52: Predictive ability results*, in *Abacus*, 1983, vol. 19, p. 130-138; and KELLY L., C*orporate management lobbying on FAS No. 8: Some further evidence*, in *Journal of Accounting Research*, 1985, vol. 23, p. 619-632.

affect financial statements. They also observed that large companies with low management ownership are more likely to lobby for or against a proposed change in currency translation rules than smaller companies with higher management ownership.

Some other authors[179] provided evidence that managers might tune the timing of adoption of accounting rules in order to influence the reported earnings. In particular, they found evidence of earnings management when considering when companies choose to adopt new currency translation pronouncement introduced in GAAP. In fact, when a new accounting standard is adopted and its mandatory adoption is deferred to future years, voluntary early adoption may provide an opportunity to manage the earnings. The rationale lays down the belief that a company can take the advantage of manage earnings by changing the time an accrual basis rather than cash basis those are recorded as expense on a cash basis. In the field of foreign currency translation, evidence regarding adoption dates for the U.K.'s currency translation pronouncement (Statement of Standard Accounting Practice No. 20) shows that companies chose to defer adoption of the standard to influence their financial performance and, achieve certain corporate financial objectives.[180] Furthermore, results showed that managements tended to adopt new accounting rules when the adverse economic consequences of adoption were likely to be minimal, so as to achieve better financial performance and earnings quality[181].

---

[179] IATRIDIS G., JOSEPH N., *Characteristics of UK firms related to timing of adoption of Statement of Standard accounting practice No. 20*, in *Accounting and Finance*, 2006, vol. 46, p. 429-455; and IATRIDIS G., JOSEPH N., *A conceptual framework of accounting policy choice under SSAP 20*, in *Managerial Auditing Journal*, 2005, vol. 20, p. 763-778.

[180] IATRIDIS G., JOSEPH N., *Characteristics of UK firms related to timing of adoption of Statement of Standard accounting practice No. 20*, cited.

[181] For a discussion on earning quality and its management perceptions, see HOLT P.E., *Critical elements of foreign currency translation: a worldwide informational and accounting problem*, in *American Journal of Economics and Business Administration*, cited.

8. Theories on the impact of foreign currency translation on financial statements and on market reactions.

A number of foreign currency translation articles documented on the impact of foreign currency translation adjustments on financial statements and on market reaction[182]. These studies are based on the assumption that foreign currency translation adjustments provide a measure, albeit an imperfect one, of the exchange rate exposure faced by multinational firms.

The issue of exchange rate exposure has been examined by accounting researchers for more than a quarter century, providing mixed results[183].

[182] For an analysis on the market studies, see BARTOV E., *Foreign Currency Exposure of Multinational Firms: Accounting Measures and Market Valuation*, in *Contemporary Accounting Research*, Winter 1997, vol. 14, no. 4, p. 623-652; BRYANT M., SHANK J.K., *FASB 8: questioning the economic impact*, in *The Accounting Forum*, December 1977, p. 11-29; BAZAZ M.S., SENTENEY D.L., *Value relevance of unrealized foreign currency translation gains and losses*, in *American Journal of Business*, 2001, vol. 16 Issue 2, p. 55–62; CHAMBERS D., et al., *An evaluation of SFAS no. 130 comprehensive income disclosures*, in *Review of Accounting Studies*, December 2007, vol. 12, Issue 4, p. 557-593; COLLINS D., SALATKA W., *Noisy accounting earnings signals and earnings response coefficients: the case of foreign currency accounting*, in *Contemporary Accounting Research*, 1993, vol. 10, p. 119-159; KWON T.H., et al., *Do foreign investors price foreign exchange risk differently?*, in *Journal of Financial Research*, 2005, vol. 28, Issue 4, p. 555-573; LOUIS H., *The value relevance of the foreign translation adjustment*, in *Accounting Review*, October 2003, vol. 78, Issue 4, p. 1027-1047; WANG Y., et al., *The value relevance of dirty surplus accounting flows in the Netherlands*, in *International Journal of Accounting*, 2006, vol. 41, Issue 4, p. 387-405; ZIEBART D.A., KIM, D.H., *An examination of the market reactions associated with SFAS no. 8 and SFAS no. 52*, in *Accounting Review*, April 1987, p. 343-357; SOO B.S., SOO L.G., *Accounting for the multinational firm: is the translation process valued by the stock market?*, in *The Accounting Review*, 1994, vol. 69, no. 4, p. 617-637; and PINTO, J.A.M., *How Comprehensive is Comprehensive Income? The Value Relevance of Foreign Currency Translation Adjustments*, in *Journal of International Financial Management & Accounting*, 2005, vol. 16, no. 2, p. 97-122.

[183] For an analysis on the studies of the impact of translation methods on financial statements, see, among others, AGGARWAL R., *FASB No. 8 and reported results for multinational operations: hazard for managers and investors*, in *Journal of Accounting Auditing and Finance*, 1978, vol. 1, p. 197-216; BIEL H.H.,. *Foreign Woes: Foreign Exchange Losses are Proving Costly for Many Multinationals*, 1976, in *Forbes*, vol. 1, p. 95; PORTER G.A., *Foreign currency accounting FAS 8 or 52? multinationals experiment*, in *Massachusetts CPA Review*, Summer 1983, p. 48-54; SELLING T.I., SORTER G.H., *FASB Statement No. 52 and Its Implications for Financial Statement Analysis*, in *Financial Analysts Journal*, 1983, vol. 39, p. 64-69; RECKERS P.M.J., TAYLOR M.E., *FASB No 8. Does it Distort financial statements*, in *The CPA Journal*, August 1978, p. 31-34; LIU J., *On International Accounting Valuation*, in *Journal of International Accounting Research*, 2006, vol. 5, p. 67-87; HOLT P.E., *The variability of earnings across foreign currency translation methodologies: an empirical*

More in detail, there are numerous research articles in the accounting literature that observed whether lower variability of reported earnings result in more useful information. Researches on US multinationals documented that requirements of FAS 8 (temporal rate method) were perceived by many financial statement users, especially managers, to result in greater variability of reported earnings than other possible translation methodologies. They concluded that including the translation adjustments in net income (non deferral, as prescribed by FAS 8) resulted in consolidated financial statements that did not reflect economic reality on the assumption that these adjustments generate noise that made reported earnings less meaningful[184]. In this sense, they alleged that the principles of FAS 8 are likely to introduce variability in book values and reported earnings which is viewed by managers and other users as undesirable and less accurate depictions of results of operations than lower variability of earnings.

By contrast, other studies revealed that FAS 8 is not likely to always result in higher volatility of earnings than FAS 52[185].

Existing literature also tested the value relevance of foreign currency translation adjustments in earnings and book value modes. On this point, research results were contrasting. In fact, some empirical evidence showed that there was no perceived difference in the market's valuation of the firm related to the foreign exchange adjustment between FAS 8 (temporal method) and

---

comparison, in *Southwest Business and Economics Journal*, 2006, p. 67-81; and HOLT P.E., *Comparative information content of return on assets based alternative translation methods*, in *Southwest Business and Economics Journal*, 2005, vol. 12, p. 9-17.

[184] COLLINS D., SALATKA W., *Noisy accounting earnings signals and earnings response coefficients: the case of foreign currency accounting*, in *Contemporary Accounting Research*, cited.

[185] BEAVER W.H., WOLFSON M.A., *Foreign Currency Translation Gains and Losses: What Effect Do They Have and What do They Mean?*, in *Financial Analysts Journal*, 1982, March/April, pp. 28-36. Similar non-systematic effects were shown by DUANGPLOY O., *The Sensitivity of Earnings Per Share to Different Foreign Currency Translation Methods*, in *International Journal of Accounting Education and Research*, 1979, Spring, pp. 121-134.

FAS 52 (current rate method)[186]. Other researchers found that the FAS 52 requirements caused reported earnings to be more relevant for market valuation than FAS 8[187].

Although these studies documented that exchange rate changes, as measured by foreign currency translation adjustments, produce heterogeneous influences on equity valuation, a study conducted by Pinto[188] suggested that "other items of comprehensive'' income, of which foreign currency translation adjustments are the largest element for most firms[189], are a significant source of value-relevant information for investors.

Moreover, in a simulation study, it was noted that the temporal method of FAS 8 was extremely sensitive to the proportion of debt in the capital structure[190].

Among the market studies, an analysis was conducted to investigate the extent to which FAS 52 unrealized foreign currency translation gains and losses are reflected in levels of equity security prices[191]: they found that using numbers closer to the equilibrium exchange rate would increase the studied relationship, although this has not yet been demonstrated with normative research.

---

186 SOO B.S., SOO L.G., *Accounting for the multinational firm: is the translation process valued by the stock market?*, in *The Accounting Review*, 1994, vol. 69, no. 4, p. 617-637.

187 BARTOV E., *Foreign Currency Exposure of Multinational Firms: Accounting Measures and Market Valuation*, in *Contemporary Accounting Research*, Winter 1997, vol. 14, no. 4, p. 623-652.

188 PINTO, J.A.M., *How Comprehensive is Comprehensive Income? The Value Relevance of Foreign Currency Translation Adjustments*, in *Journal of International Financial Management & Accounting*, 2005, cited. "The results of this study contradict the notion that foreign currency translation adjustments are mere ‘‘bookkeeping’’ entries and thus do not affect valuation until some unspecified future date when net foreign assets are disposed of and converted into dollars." (See, PINTO, J.A.M., 2005,p. 117).

189 DEE C.C., *Comprehensive Income and Its Relation to Firm Value and Transitory Earnings*, 1999, Working Paper, Louisiana State University.

190 RUPP G.L., *A simulation study of alternative methods for translating statements of autonomous foreign entities*, Unpublished Ph.D. Dissertation, 1982, Oklahoma State University.

191 BAZAZ M.S., SENTENEY D.L., *Value relevance of unrealized foreign currency translation gains and losses*, in *American Journal of Business*, cited.

A further research was carried out to study the association between change in firm value and the foreign translation adjustment[192]. This economic analysis was made by comparing changes in firm value with the translation adjustment and it was observed that the translation adjustment is inversely related to an increase in value. In this sense, accounting rules for currency translation usually result in financial statement numbers opposite to the economic effects of exchange rate variations. Thus, the translation adjustment could be associated with a loss of value instead of an increase in value.

[192] LOUIS H., *The value relevance of the foreign translation adjustment*, in *Accounting Review*, cited.

Appendix A

Example of translation of a non-hyperinflationary functional currency to a non-hyperinflationary presentation currency.

An Italian company adopting IAS/IFRS has defined its functional currency as the USD. In compliance with Italian law, the company prepares and files its annual financial statements in Euro.

The company was incorporated on January 1, 2015 with a share capital amounting to USD 300.

On March 10, 2015, it purchased professional services from Italian consultants for Euro 100 (that is, foreign currency transaction). The payment has been made on June 10, 2015.

The exchange rate on March 10, 2015 was 0,72 (amount of Euro for 1 USD).

At the date of the purchase, the company converted the cost expressed in Euro into its functional currency (USD) at the exchange rate of the date of the purchase (Euro 100 / 0,72 = USD 138,88).

The accounting records are as follows:

Professional services	**@**	**Debt**	138,88

On June 10, 2015, i.e., the date in which the payment is made, the USD/ Euro exchange rate is 1 USD = 0,77 Euro.

Debt in Euro (foreign currency)	**100 Euro**
Exchange rate at the date of transaction (initial recognition in accounts)	**1 USD = 0,72 Euro**
Exchange rate as at 10/06/2015	**1 USD = 0,77 Euro**
Initial recognition in accounts	**100/0,72 = 138,88 USD**
Value recorded in the financial statements	**100/0,77 = 129,87 USD**
Foreign exchange difference (gain)	**9,01 USD**

The Profit and Loss Account ("P&L") and the Balance Sheet ("BS") in USD (functional currency) are the following**:**

Table 1. Financial statements in USD for 2015

P&L accounts (USD)	**Assets (USD)**	**Liabilities (USD)**
Bank Share capital Debts Statutory loss	170,13	 300 - -129,87
Total	**170,13**	**170,13**
BS accounts (USD)	**Costs (USD)**	**Revenues (USD)**
Professional services Foreign exchange gains Statutory loss	138,88	 9,01 129,87
Total	**138,88**	**138,88**

In order to prepare and file the separate financial statements in Euro, the company converts the values recorded in the P&L and in the BS according to the criteria set forth by IAS 21:

a) The items accounted for in the P&L are converted at the average rate for the period which is assumed to be '1 USD = 0,72 Euro';
b) The items accounted for in the BS are converted at the year-end exchange rate, which is assumed to be '1 USD = 0,50 Euro';
c) The value of the net equity (which in this specific case is equal to the share capital) is converted at the historical exchange rate which is assumed to be '1 USD = 0,69 Euro'.

These conversions are illustrated below.

a) Conversion of the Profit and Loss Account values

Professional services	138,88 USD * 0,72	100 Euro
Exchange gain	9,01 USD * 0,72	6,48 Euro
Statutory loss		93,52 Euro

b) Conversion of the Balance Sheet values

Bank	170,13 USD * 0,50	85,06 Euro
Share Capital	300 USD * 0,69	207 Euro
Statutory loss	As resulting from the conversion of P&L Account	93,52 Euro

As a result of the conversion, the assets amount to Euro 85,06, while the sum of the liabilities and the net equity amounts to Euro 113,48 (i.e., 207 – 93,52). Therefore, a difference exchange (loss) amounting to Euro 28,42 arises from the translation above.

The financial statements of the company translated to Euro are the following:

Balance Sheet as at 31/12/2015 (translated to Euro)			
Bank	85	*Net equity*	
		Share capital	207
		Exchange Reserve	(28)
		Statutory loss	(94)
		Total Net Equity	***85***
		Debts	-
TOTAL ASSETS	**85**	**TOTAL LIABILITIES**	**85**

Separate Profit and Loss Account as at 31/12/2015 (translated to Euro)	
Costs	(100)
Exchange Gain	6
STATUTORY LOSS	**(94)**

OCI – Other Comprehensive Income (Euro)	
Profit/(loss)	(94)
Profit/(loss) arising from the translation from the functional currency into the presentation currency	(28)
TOTAL PROFIT/LOSS	**(122)**

CHAPTER THREE

THE FUNCTIONAL CURRENCY CHOICE AND ITS EFFECTS ON THE ACCOUNTING AND FINANCIAL REPORTING OF ITALIAN COMPANIES: AN EMPIRICAL CASE

1. Introduction.

In Chapter Two it was examined the functional currency approach required by IAS 21 and the indicators used to determine the functional currency from a parent company perspective and from a local perspective. Chapter Two went on to study the convergence between IAS/IFRS and US GAAP on the functional currency requirement (and on foreign currency translation methods) and examined the accounting theories, investigated within the context of the US GAAP about the selection of foreign currency translation methods.

This chapter more closely examines how corporations go about selecting their functional currencies and dwells on the financial statement effects of such designation. In doing so, this research approaches the subject from a local company perspective and focuses on the Italian experience through the study of an empirical case.

The purpose of this work is to consider and evaluate the effects that the functional currency approach provided by IAS 21 may have on the quality of financial reporting of Italian companies, in order to assess whether financial information reflects the real-world economic phenomena that IAS/IFRS purport to represent.

By means of the selected case study, the author attempts to provide helpful evidence to inform the debate and the decision-making process on the fact that the functional currency concept represents a crucial tool to provide financial results that faithfully represent the real economic world in which an entity operates[193].

Moreover, this study considers the extant literature on foreign currency translation methods and raises questions as to whether the choice of functional currency may, in some cases, distort the original financial relationships and mislead users of the useful information.

This suggests the need to investigate a number of areas in which knowledge of accounting practice in Italy is incomplete and for which useful contribution might be made through academic research.

2. Research questions and objectives.

The accounting issues and literature discussed in previous chapters identifies a number of gaps in the empirical research and suggest a number of useful areas to investigate.

As a preliminary remark, the adoption of IAS/IFRS by so many different jurisdictions in the world addresses interesting areas of research to examine how countries have implemented and developed the foreign currency

[193] It must be recalled that this would be consistent with both the IASB Framework and the EU Regulation 1606/2002 in their view that the two primary qualitative characteristics of information in financial statements are relevance and faithful representation.

translation system for IAS adopters. This raises a number of questions, some of which are described below:

1. Do all (or part of) European countries apply the functional currency approach laid down in IAS 21 in defining the currency of an entity? Is the concept of functional currency set forth by IAS 21 legally recognized by local jurisdictions for accounting and tax purposes?
2. For those accounting systems that accept the functional currency approach, which are the economic indicators and criteria that management of companies normally consider to determine their functional currencies? More in detail, do managers assure adherence to the functional currency indicators? Or conversely, they freely determine the entities' functional currency on the basis of the expected performance of the business?
3. Which are the effects on reporting and tax accounting for IAS adopters when the functional currency designated by an entity is a currency different from that used (or required) for reporting purposes by local regulations?

Clearly, it is beyond the scope of a single PhD research to answer fully all of the research questions raised above. Instead, this research attempts to study the effects on financial reporting in those cases in which the functional currency chosen under the criteria set forth by IAS 21 differs from that required and commonly used in a certain country for financial statements purposes.

More in detail, taking Italy as an example of jurisdiction requiring the adoption of Euro for reporting purposes, this thesis is designed to investigate the degree to which the financial performance of a company may be heavily influenced by the choice of functional currency under IAS 21 and by the application of the related foreign currency translation methods that derive from said choice.

In this context, given the complex and slightly turbulent market conditions, this work attempts to offer to authoritative bodies relevant insights into effective foreign currency translation policy making.

3. Research design and methodology.

This section focuses on the research design and methodology that direct this investigation and has the purpose to explain the rationale behind the methodology used and the approach adopted in conducting this research.

The starting point for the design of the methodology for this work is that the literature searches found no discussion of the functional currency approach in accounting under international accounting standards, although a wide debate in the context of US GAAP illustrates both the belief in and scepticism about the choice of functional currency in the accounting and reporting field. Hence, the researcher is attempting to show and provide evidence on the effects that a strict application of concept laid down in IAS 21 may have on accounting quality.

From the many possible methodological options, the most realist perspective effectively excludes some strongly positivist quantitative methods (such as self-administered questionnaires) to observe companies accounting behaviors on a comparative basis internationally. In fact it is difficult and not appropriate to observe underlying accounting quality effects by studying firms in different countries with different market and regulatory environments, especially in the financial reporting field where the practice of IAS/IFRS often differs along national lines[194].

[194] It has been observed that "[…] the reactions of different jurisdictions to IFRS differ greatly. Some have ignored it, some have allowed it; some have required IFRS for some purposes, whereas others have abolished national GAAP in favour of IFRS. Very few jurisdictions have simply imposed IFRS as issued by the IASB, although some countries (eg Canada) do incorporate IFRS into law without amendment. Others make amendments and then insert the

Moreover, it has also been excluded an empirical inquiry that tests companies' behavior in a certain territory, such as Italy, to gather a breadth of information regarding "how much" (and by "how many") the concept of functional currency is recognized and, as a consequence, applied in practice. This is because in the view of the researcher the peculiarity of the issue at hand would not have led to representative findings that could be helpful to offer supportive evidence of the point at issue.

Instead this research uses a qualitative method, aiming to study a certain phenomenon as nearly as possible as it effectively occurs e being able to analyze, describe and interpret what happens under certain conditions and in a certain context. In this sense, the qualitative researcher tries to obtain an in-depth understanding of phenomena, whilst it is recognized that an existential objective reality cannot be captured[195].

Among the different forms that that qualitative research may take[196], this research uses a case study methodology. This method was preferred because it ensures complete description of the situation (namely, an in depth study of foreign exchange effects on reporting), and full understanding of the behaviour and practices analyzed. Hence, the case study was selected as the most appropriate method in the present case to provide the pertinent information (more elaborately than statistical procedures or other means of quantification which are based on interpretivism and constructivism) and allow to develop theoretical explanation of management and accounting practices.

Whilst it is acknowledged that this methodology cannot produce *per se* statistically generalizable findings, a case study method offers opportunities to

---

result into law." See NOBES C., *International Variations in IFRS Adoption and Practice,* The Association of Chartered Certified Accountants, London, 2011, p. 5.

[195] PARKER L.D., *Qualitative Research in Accounting and Management: the Emerging Agenda*, in *Journal of Accounting and Finance*, 2003, no. 2, pp. 15-39.

[196] In academic research field, a number of qualitative research methods may be practiced by researchers. These may be, among others, in the form of case study, grounded theory, ethnography, phenomenology, focus group. See TRUMBULL M., WATSON K., *Qualitative Research Methods*, in *Integrating Quantitative and Qualitative Methods in Research*, 3rd Edition, 2010, University Press of America, pp. 62-78.

deeply understand actors and their world and study issues that are complex and context dependent.

The case study hereunder examined is based on actual occurrence. Names and data have been changed to ensure anonymity. Facts and details below described have been simplified.

4. The case study: an overview of facts.

The case here examined considers one of the major multinational group headquartered in Japan and having the ultimate company listed on the Tokyo Stock Exchange.

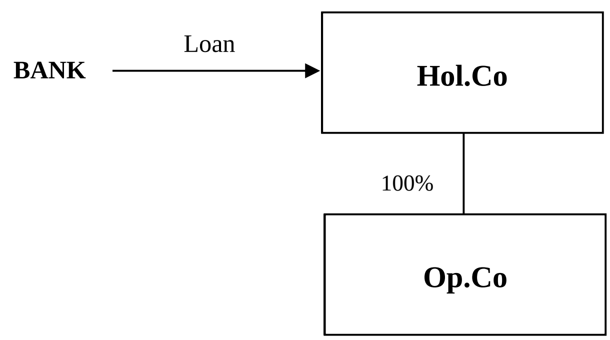
This group currently operates around 300 subsidiaries and 200 affiliated companies in the world and is active in different business segments, such as – among others – oil and gas, machinery and infrastructures, mineral and metal resources, etc. Within the oil and gas industry, the management strategy was to expand oil and gas operations and, therefore, the group invested in pipelines in Italy.

The investment in Italy was made by the group by taking the following steps:

- In early 2013, the group incorporated a company ("Hold.Co") with the main purpose to invest in the oil & gas business in Italy through the acquisition of a 100% shareholding in an Italian company acting in the Oil industry (i.e. "Op.Co").
- "Op.Co" was an independent company incorporated in 2012 in Italy that operated in the exploration and production sector, within the Oil and Gas industry. Its business activity consisted of extraction, production and trade within the Oil industry.

- In order to make the aforementioned acquisition, in 2013 Hold.Co took out two loans from two Italian Banks in order to finance the purchase of Op.Co's shares and its future business activity.
- Subsequently, during third quarter 2013, Hold.Co acquired the 100% shareholding of Op.Co from a third party. As mentioned above, the acquisition was carried out mainly through indebtedness – i.e. third party loan. The current presence of the group in Italy is represented in Figure 1.

Figure 1. Structure of the group presence in Italy



- As at today, Op.Co is carrying out the development of the oil & gas infrastructure directly or through contractors. The construction of the asset is expected to be completed within 2017. Following the completion of the construction, the company will carry out the oil & gas business (sales of products to client) performing the operation and maintenance activities. This production phase is expected to be in early 2018.
- The business role of Hold.Co consists of the management, the coordination and the funding of Op.Co during the development and construction phase of the oil & gas infrastructure and in the subsequent production phase. Furthermore, Hold.Co has treasury functions, such as (i) the management of the funds collected from the

group and from the financial institution, (ii) the financing of Op.Co with the funds necessary to carry out the construction of the oil & gas infrastructure, (iii) the optimization of the cash deployment, and (iv) the management of exchange rate differences.

- Both Hold.Co and Op.Co (together the "Companies") apply the IAS/IFRS accounting standards. Hence, the question of which currency to use in keeping the Companies' books and accounts arose at once. Further to deep analysis, the management and auditors stated that the functional currency would have been the U.S. dollar and the presentation currency the Euro (as required by Italian law). The reasons given for the designation of the USD as functional currency are explained in the next paragraph.

5. Reasons given for choosing the US dollar as functional currency.

Further to an examination of indicators stated by IAS 21, the management – supported by the auditors – gave the following reasons for choosing the US dollar as the Companies' functional currency.

With reference to Op.Co, the decisive arguments in favour of identifying the US dollar as the functional currency were that:

- it shall sell a product (the oil) that is universally priced in US dollar and hence, it is the latter the currency in which sales prices shall be denominated and settled under commercial contracts;
- receipts from operating activities will be retained in US dollar.

With regard to Hold.Co, given its nature of holding company having the sole purpose to hold the participation in and to finance Op.Co, the conclusions of the management were based on the following different economic criteria[197]:

- as all loans borrowed by Hold.Co were denominated in US dollar, it is the latter the currency in which funds from financing activities are generated;
- dividends that Hold.Co is expected to receive from Op.Co shall be denominated and paid in US dollar.

6. Effects of the decision.

The decision to possibly adopt the U.S. dollar as the functional currency for the Companies created considerable preliminary issues for the management.

The reason for this lied in the difficulty of implementing this decision within the Italian context as the concept of the functional currency was a "foreign concept" in Italy, being therefore an uncovered issue in the Italian regulatory environment.

In particular, main difficulties caused by adopting US dollar as the functional currency were the following:

1. As the Italian law does not expressly allow entities to keep their books and accounts in a currency other than the home currency (thus implying that they should be, in principle, held in Euro), the Companies decided to develop an accounting system that would have enable accountants to record transactions simultaneously in

[197] The indicators used for Op.Co are mostly relevant for sales and production companies, as these refer to sales prices for goods and services (indicators under IAS 21, par. 9, let. a) and receipts from operational activities (indicators under IAS 21, par. 10, let. a). These indicators were found inadequate for a holding and finance company that provides financial services and realizes investment income (i.e. dividends). For these latter cases, factors such as funds from financing activities and receipts from operating activities should be considered (indicators under IAS 21, par. 10).

US dollar (functional currency) and in Euro. Hence, a sort of "double accounting system" was set up so that each transaction would have been recorded in two bookkeeping entries[198]. This system included two independent set of entries (one for each currency used) and each of them was managed as if accounts were kept in one simple bookkeeping entry. This double work that the Companies had to do for accounting for transactions was a monumental task that, for the year of implementation, delayed the publication of the annual accounts. For subsequent years, the Companies continued to manage the accounting both in US dollar (functional currency) and in Euro.

2. A further issue was caused by the fact that the Companies' financial statements had to be presented in any case in Euro (defined by IAS 21 as "presentation currency"). Recall that for IAS adopters, Italian law provides that the financial statements of a single entity (as well as the consolidated financial statements) are prepared in euro, as per Article 16 of Legislative Decree of June 24, 1998 n. 213" (paragraph 2)[199]. Considering that the functional currency adopted was the US dollar under IAS 21, both the Companies had to apply at each financial year-end the translation procedure stated by IAS 21 to convert the functional currency accounts into the presentation currency (Euro). As it will

[198] In this regard, it must be highlighted that the approach adopted by the management was not that of setting a multicurrency accounting system. In fact, as dealt with in Chapter One, the multicurrency accounting approach implies that the accounting picture is unique as it includes both records that are expressed in the functional currency and account balances in foreign currencies.

[199] See Article 5, par. 2, of Italian Legislative Decree no. 38 of 28 February 2005 (regarding the exercise of the options provided for in Article 5 of the EC Regulation no. 1606/2002 relating to the International Financial Reporting Standards) where it is provided that "*the financial statements of a single entity and the consolidated financial statements, prepared in accordance with the international accounting standards are prepared in euro, as per Article 16 of Legislative Decree of June 24, 1998 n. 213*". This latter provision provides for that starting from 1st January 2002, the adoption of the Euro is mandatory for any purposes.

be deeply examined in next paragraphs, this procedure may have relevant impacts on the business results of the entities.

3. Additional problems arose at the time the Companies' taxable income had to be computed. In particular, the current tax legislation does not provide for any specific criteria for converting, for tax purposes, in the present case the accounts from USD (functional currency) to Euro (presentation currency). Nor it was clear to mangers how the exchanges differences that arose from the translation from the functional currency into the presentation currency (and recorded in net equity under IAS 21) had to be treated for tax purposes.

The following paragraphs show the effects that the designation of USD as functional currency had on the 2013 financial statements of the Companies and on the calculations of taxes due for the period.

7. Impacts of the functional currency choice on the accounting and financial reporting of the Companies.

As noted above, in the course of their business the Companies recorded day-to-day operations in US dollar, the latter being their functional currency.

Tables 1 and 2 (below) present the accounts respectively for Hold.Co and Op.Co at December 31, 2013 prepared in US dollar (functional currency).

Table 1. Hold.Co trial balance for FY 2013 in US dollar.

HOLD.CO – 2013 TRIAL BALANCE	
Balance Sheet	**Balance (USD)**
Participation	531,562,361
Capitalized expenses	643,384
Down payments	2,213
Invoices to be issued to Op.Co	420,653

Banks	4,821,644
VAT Receivables	47,116
Share Capital	(78,206)
Advance paid in capital	(200,000,000)
Financial Loans	(336,999,990)
Invoices to be received	(294,667)
Invoices to be received – Group	(1,722,309)
Payables	(21,657)
Withholding Taxes	(9,559)
Current taxes	(2,996,856)
Deferred Tax assets	224,853
Deferred Tax liabilities	(216,764)
Accrued interests	(99,864)
P&L Account	**Balance (USD)**
Services	66
Fiscal consultancy	162,325
Technical consultancy	325,977
Legal consultancy	198,159
Other consultancy	213,665
Management Fee	240,032
Charges from Parent Company	26,694
Guarantee Fee	1,034,930
Audit fee	154,632
Stamp duty	56
Other taxes	273,750
Bank charges	81
Bank commissions	150,000
FX Loss not realized	106,896
FX Loss Realized	185,827
FX Gain Realized	(1,344,207)
Current taxes	2,996,856
Deferred Tax liabilities	216,764
Deferred Tax assets	(224,853)
(PROFIT) LOSS FOR THE PERIOD	**4,717,649**

Table 2. Op.Co trial balance for FY 2013 in US dollar.

OP.CO – 2013 TRIAL BALANCE	
Balance Sheet	**Balance (USD)**
Concession	78,009,289
Other exploration expenses	164
Building	20,705
Other plants	42,924

Dwells Work In Progress	46,626,957
Reserves Work In Progress	86,206,622
Stock	1,897,245
Advance payments	16,085,308
Other receivables	1,046
Banks	66,742
Prepaid expenses	17,514
FTA Reserve	24,564
Other reserves	1,601
VAT receivables	9,653,592
WH tax on bank interests	1
Deferred tax asset	826,402
Share capital	(200,097,703)
Other reserves	(5,165)
Advances paid in capital	(23,879,243)
Previous years accrual for risks	(6,674,909)
Invoices to be received	(635,470)
Invoices to be received from Hold.Co	(420,653)
Payables	(628,366)
WH tax to be paid	(5,459)
Net working capital	(7,752,939)
Accumulated depreciation Other exploration expenses	(164)
Accumulated depreciation Buildings	(7,051)
Accumulated depreciation Other plants	(42,924)
Doubtful receivables	(124,788)
Accrued costs	(19,274)
P&L Account	**Balance (USD)**
Technical services	94,577
Fiscal fee	56,414
Legal fee	59,530
Management Fee	374,995
Charges from Parent Company	45,658
Sole auditor	27,316
Audit fee	56,888
Costs for environment	517,163
Other services	146
Insurance expenses	52,581
G&G cost	12,338
Car rental	81
Stamp duty and other local taxes	799
Public duties	207,734
Bank charges	175
FX losses not realized	196,513
FX losses realized	62,406
Depreciation – building	2,070
Depreciation – Other exploration expenses	161

Provision for bad debt	124,788
Reversal of deferred tax asset	802
Deferred tax asset	(810,871)
Income interest	(4)
Other income interests	(91)
FX gain realized	(46,642)
FX gain not realized	(222,095)
(PROFIT) LOSS FOR THE PERIOD	**813,431**

Based on the above accounts, it results that for FY 2013 Hold.Co recorded a loss amounting to 4,717,649 USD and Op.Co a loss of 813,431 USD. Moreover, all exchange differences recorded in the P&L accounts of the Companies and affecting the earnings of the period arise from translation of transactions that are denominated in foreign currencies, i.e. in a currency different from the functional currency. In the present case, Hold.Co and Op.Co manage transactions that are expressed in Euro (foreign currency) and it is from these transactions that realized and non-realized exchange differences derive.

After recording all transactions for the period in US dollar (functional currency), the Companies had to prepare their financial statements in Euro (presentation currency), as required by Italian law. This implied that they had to translate their accounts and financial position from USD to Euro, by applying the translation criteria stated by IAS 21 (current rate method)[200]. In particular:

f. assets and liabilities were translated at the closing rate (i.e., ‘1 EUR = 1.3791 USD’ as at 31 December 2013);
g. income and expenses recorded in the P&L account were translated by applying the exchange rates at the date of transaction;
h. the items of the net equity were converted at the historical exchange rate.

[200] IAS 21, par. 39 and subsequent ones.

The translation procedures and the relevant results are illustrated in next sections.

7.1. Translation of the Hold.Co accounts from USD (functional currency) into Euro (presentation currency).

The P&L account and the statement of financial positions of Hold.Co for fiscal year 2013 translated from the functional currency into Euro are presented in tables 3 and 4 below.

Table 3. Hold.Co – Translation of the P&L account.

P&L ACCOUNT	Balance (USD)	F/X rate	Balance (EUR)
Services	66	Date of trans.	48
Fiscal consultancy	162,325	Date of trans.	118,431
Technical consultancy	325,977	Date of trans.	251,063
Legal consultancy	198,159	Date of trans.	146,527
Other consultancy	213,665	Date of trans.	165,344
Management Fee	240,032	Date of trans.	174,050
Charges from Parent Company	26,694	Date of trans.	19,356
Guarantee Fee	1,034,930	Date of trans.	750,439
Audit fee	154,632	Date of trans.	112,125
Stamp duty	56	Date of trans.	42
Other taxes	273,750	Date of trans.	198,730
Bank charges	81	Date of trans.	61
Bank commissions	150,000	Date of trans.	108,893
FX Loss not realized	106,896	Date of trans.	77,511
FX Loss Realized	185,827	Date of trans.	144,858
Current taxes	2,996,856	Date of trans.	2,173,052
Deferred Tax liabilities	216,764	Date of trans.	157,178
FX Gain Realized	(1,344,207)	Date of trans.	(1,018,461)
Deferred Tax assets	(224,853)	Date of trans.	(163,043)
Profit (Loss)	***(4,717,649)***		***(3,416,203)***

Table 4. Hold.Co – Translation of the Balance Sheet account

BALANCE SHEET	Balance (USD)	F/X rate	Balance (EUR)
Participation	531,562,361	1.3791	385,441,492
Capitalized expenses	643,384	1.3791	466,524
Down payments	2,213	1.3791	1,605
Invoices to be issued to Op.Co	420,653	1.3791	305,020
Banks	4,821,644	1.3791	3,496,225
VAT Receivables	47,116	1.3791	34,165
Deferred Tax Assets	224,853	1.3791	163,043
Total Assets	***537,722,224***		***389,908,074***
Share Capital	78,206	Date of trans.	60,000
Advance paid in capital	200,000,000	Date of trans.	146,541,707
Profit (Loss)	As resulting from the P&L (converted as per Table 3, above)		(3,416,203)
Financial Loans	336,999,990	1.3791	244,362,258
Invoices to be received	294,667	1.3791	213,666
Invoices to be received - Group	1,722,309	1.3791	1,248,865
Payables	21,657	1.3791	15,704
Withholding Taxes	9,559	1.3791	6,932
Current taxes	2,996,856	1.3791	2,173,052
Deferred Tax liabilities	216,764	1.3791	157,178
Accrued interests	99,864	1.3791	72,412
Total Liabilities and Net Equity	***542,439,873***		***391,435,571***

By applying the translation criteria set forth by IAS 21, it emerges that Hold.Co total assets amount to Euro 389,908,074, while the amount of liabilities and the net equity is equal to Euro 391,435,571. The arising difference (a loss of Euro 1,527,497) represents the foreign exchange difference that results from:

3. translating income and expenses at the dates of the transactions and assets and liabilities at the closing rate (‘1 EUR = 1.3791 USD’ as at 31 December 2013);
4. translating the opening net assets at the opening rate (date of transaction) that differs from the closing rate (‘1 EUR = 1.3791 USD’ as at 31 December 2013).

As indicated by IAS 21, this exchange difference is recognized in a separate component of equity[201] (also known as 'exchange reserve') and is made up as follows:

Item	**Closing rate (EUR)**	**Date of transaction (EUR)**	***Differences (EUR)***
Profit (loss) for the period	(3,420,817)	(3,416,203)	*(4,614)*
Share capital	56,708	60,000	*(3,292)*
Advance paid in capital	145,022,116	146,541,707	*(1,519,591)*
Exchange reserve			***(1,527,497)***

The 2013 financial statements of Hold.Co translated from USD (functional currency) to Euro are presented in table 5.

Table 5. Hold.Co – Financial Statements filed for FY 2013

Hold.Co – Balance Sheet as at 31 December 2013	**(in Euro)**
Intangible assets	466,524
Participation	385,441,492
Deferred tax assets	163,043
Total non-current assets	***386,071,059***
Commercial receivables	306,625
Other receivables	34,165
Banks	3,496,225
Total current assets	***3,837,015***
TOTAL ASSETS	**389,908,074**
Share Capital	60,000
Reserves	146,541,707
Exchange reserve IAS 21	(1,527,497)
Profit (loss) of the year	(3,416,203)
Total net equity	***141,658,007***
Non-current liabilities	244,362,258

[201] According to IAS 21 (par. 41), these exchange differences are not recognized in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations.

Deferred tax liabilities	157,178
Total non-current liabilities	***244,519,436***
Commercial payables	1,478,235
Other payables	72,412
Tax payables	2,179,984
Total current liabilities	***3,730,631***
TOTAL LIABILITIES	**389,908,074**

Hold.Co - Profit and Loss Account as at 31 December 2013	**(in Euro)**
Revenues	-
Other Costs	(1,737,424)
Exchange gains	1,018,461
Exchange losses	(222,369)
Financial costs	(307,684)
Profit before taxes	***(1,249,016)***
Taxes	(2,167,187)
PROFIT (LOSS)	**(3,416,203)**

Hold.Co - OCI – Other Comprehensive Income as at 31 December 2013	**(in Euro)**
Profit (loss) for the period	(3,416,203)
Exchange reserve IAS 21	(1,527,497)
PROFIT (LOSS)	**(4,943,700)**

7.2. Translation of the Op.Co accounts from USD (functional currency) into Euro (presentation currency).

Similarly, Op.Co implemented the above described translation procedure in order to re-express its accounts from US dollar into Euro for the purpose of presenting its financial statements for fiscal year 2013.

Table 6 (here below) shows how this translation have been reflected in the 2013 financial statements presented by Op.Co.

Table 6. Op.Co – Financial Statements filed for FY 2013

Op.Co - Balance Sheet as at 31 December 2013	**(in Euro)**
Tangible assets	96,328,934
Concession	56,565,361
Receivables	6,999,923
Advance payments	11,573,142
Deferred tax assets	599,233
Total non-current assets	***172,066,593***
Other receivables	12,700
Stock	1,375,712
Banks	48,395
Total current assets	***1,436,807***
TOTAL ASSETS	**173,503,400**
Share Capital	149,259,811
Reserves	17,853,471
Exchange reserve IAS 21	(4,711,675)
Profit (loss) of the year	(598,609)
Total net equity	***161,802,998***
Previous years accrual for risks	4,840,047
Total non-current liabilities	***4,840,047***
Commercial payables	6,842,420
Other payables	17,935
Total current liabilities	***6,860,355***
TOTAL LIABILITIES	**173,503,400**

Op.Co - Profit and Loss Account as at 31 December 2013	**(in Euro)**
Revenues	-
Depreciation	(1,654)
Other Costs	(1,193,417)
Exchange gains	199,082
Exchange losses	(190,891)
Profit before taxes	***(1,186,880)***
Taxes	588,270
PROFIT (LOSS)	**(598,610)**

Op.Co - OCI – Other Comprehensive Income as at 31 December 2013	**(in Euro)**
Profit (loss) for the period	(598,610)

Foreign exchange reserve (IAS 21)	(4,711,675)
PROFIT (LOSS)	**(5,310,285)**

The above results indicate that a foreign exchange reserve of 4,711,675 Euro has been shown in the stockholders' equity of the balance sheet as comprehensive loss in accordance with IAS 21. This difference arises as follows:

Item	**Closing rate (EUR)**	**Date of transaction (EUR)**	***Differences (EUR)***
Profit (loss) for the period	(589,828)	(598,610)	*(8,782)*
Share capital	145,092,961	149,259,811	*(4,166,850)*
Reserves	17,317,428	17,853,471	*(536,043)*
Exchange reserve			***(4,711,675)***

8. Discussion of results.

This section of the thesis draws meaning and implication from the results presented and described in previous paragraphs. It is divided into two sections:

- Paragraph 8.1 focuses on the implications that a rigorous application of the functional currency criteria stated by IAS 21 may have on financial reporting of the Companies; this section is also concerned with testing the theoretical observations on foreign currency translation methodologies discussed in Chapter Two (paragraph 7);
- Paragraph 8.2 examines the tax implications of these findings for Italian based entities.

8.1. Implications of the functional currency choice on the financial statements.

This section is aimed at testing and explaining the degree to which the choice of functional currency might have impacts on the reported earnings of the Companies.

In order to reach supportive evidence of this impact, it has been assessed what would have been the effects on the Companies' financial reporting if the functional currency approach laid down in IAS 21 was ignored. Here, the study compares the accounting data reported in the official financial statements filed by the Companies (having the US dollar as functional currency under IAS 21 and Euro as presentation currency to comply with Italian law) with those reported in the non-official books of accounts recorded in Euro (thus considering the Euro as both functional and presentation currency).

This comparison was made possible because in 2013 day-to-day operations of the Companies were recorded both in US dollar and in Euro in two separate and independent bookkeeping systems. This means that all transactions occurred in 2013 have been measured not only in US Dollar (the latter being their functional currency) but also in Euro.

Tables 7 and 8 show the accounting balances, respectively for Hold.Co and Op.Co, resulting from their books of accounts denominated in Euro.

Table 7. Hold.Co accounts for FY 2013 in EUR.

HOLD.CO – ACCOUNTS FY 2013	
Balance Sheet	**Balance (EUR)**
Participation	396,564,731
Capitalized expenses	476,463
Down payments	1,637
Other receivables	43
Invoices to be issued to Op.Co	305,020
Banks	3,496,225
VAT Receivables	34,837
Share Capital	(60,000)
Advance paid in capital	(146,541,707)
Financial Loans	(244,362,258)
Invoices to be received	(213,666)

Invoices to be received – Group	(1,248,864)
Payables	(15,860)
Withholding Taxes	(7,046)
Current taxes	(2,173,052)
Deferred Tax assets	163,043
Deferred Tax liabilities	(157,178)
Accrued interests	(72,412)
P&L Account	**Balance (EUR)**
Fiscal consultancy	118,561
Technical consultancy	10,507
Legal consultancy	173,766
Other consultancy	377,169
Management Fee	174,049
Charges from Parent company	19,356
Guarantee Fee	750,439
Audit fee	112,125
Stamp duty	34
Other taxes	198,730
Bank charges	61
Bank commissions	108,893
FX loss not realized	7,529
FX loss realized	6,070,587
FX gain realized	(15,907,391)
FX gain not realized	(571,557)
Current taxes	2,173,052
Deferred tax liabilities	157,178
Deferred tax assets	(163,043)
(PROFIT) LOSS FOR THE PERIOD	**(6,189,956)**

Table 8. Op.Co accounts for FY 2013 in EUR.

OP.CO – ACCOUNTS FY 2013	
Balance Sheet	**Balance (EUR)**
Concession	49,809,500
Other exploration expenses	122
Buildings	15,444
Other plants	32,019
Dwells Work In Progress	34,744,116
Reserves Work In Progress	64,207,298
Stock	1,413,539
Advance payments	15,399,875
Other receivables	16
Banks	48,395
Prepaid expenses	13,193
FTA Reserve	18,323

VAT receivables	7,208,838
Deferred tax asset	599,170
Share capital	(149,259,811)
Other reserve	(3,853)
Advances paid in capital	(17,866,298)
Invoices to be received	(460,786)
Invoices to be received from Hold.Co	(305,020)
Payables	(454,876)
WH tax to be paid	(4,017)
Net working capital	(5,621,738)
Accumulated depreciation exploration expenses	(122)
Accumulated depreciation buildings	(5,246)
Accumulated depreciation other plants	(32,019)
Doubtful receivables	(92,400)
Accrued costs	(13,976)
P&L Account	**Balance (EUR)**
Technical services	70,708
Fiscal fee	41,565
Legal fee	43,032
Management fee	271,913
Charges from Parent company	33,107
Sole auditor	20,795
Audit fee	41,250
Costs for environment	375,000
Other services	111
Insurance expenses	39,175
G&G cost	9,272
Car rental	60
Stamp duty and other local taxes	610
Public duties	156,250
Other expenses	450
Bank charges	133
FX losses not realized	246
FX losses realized	96
Depreciation – Buildings	1,544
Depreciation – Other exploration expenses	122
Provision for bad debt	92,400
Deferred tax asset	(587,360)
Income interests	(3)
Other income interests	(68)
FX gain realized	(96)
(PROFIT) LOSS FOR THE PERIOD	**610,311**

The above records have been examined and summarized by the author to offer a direct comparison between reporting results under the application of IAS 21 (i.e. USD as functional currency and Euro as presentation currency to comply with Italian law) and those in case of adoption of Euro as the sole currency adopted for accounting and reporting purposes. Table 9 shows a comparison of these two sets of financial statements for Hold.Co.

Table 9. Hold.Co – Comparison of financial statements

Hold.Co – Balance Sheet as at 31 December 2013	**Based on IAS 21 (values in Euro)**	**Based on EUR accounts (values in Euro)**
Intangible assets	466,524	476,463
Participation	385,441,492	396,564,731
Deferred tax assets	163,043	163,043
Total non-current assets	***386,071,059***	***397,204,237***
Commercial receivables	306,625	306,657
Other receivables	34,165	34,880
Banks	3,496,225	3,496,225
Total current assets	***3,837,015***	***3,837,762***
TOTAL ASSETS	**389,908,074**	**401,041,999**
Share Capital	60,000	60,000
Reserves	146,541,707	146,541,707
Exchange reserve IAS 21	(1,527,497)	-
Profit (loss) of the year	(3,416,203)	6,189,956
Total net equity	***141,658,007***	***152,791,663***
Non-current liabilities	244,362,258	244,362,258
Deferred tax liabilities	157,178	157,178
Total non-current liabilities	***244,519,436***	***244,519,436***
Commercial payables	1,478,235	1,478,390
Other payables	72,412	72,412
Tax payables	2,179,984	2,180,098
Total current liabilities	***3,730,631***	***3,730,900***
TOTAL LIABILITIES	**389,908,074**	**401,041,999**

Hold.Co – P&L Account as at 31 December 2013	**Based on IAS 21 (values in Euro)**	**Based on EUR accounts (values in Euro)**

Revenues	-	-
Other Costs	(1,737,424)	(1,736,006)
Exchange gains	1,018,461	16,478,948
Exchange losses	(222,369)	(6,078,115)
Financial costs	(307,684)	(307,684)
Profit before taxes	***(1,249,016)***	***8,357,143***
Taxes	(2,167,187)	(2,167,187)
PROFIT (LOSS)	**(3,416,203)**	**6,189,956**

By comparing and examining the above financial results for Hold.Co, it emerges clearly that a decisive difference exists in the reported earnings of the period. In fact, while the P&L presented under IAS 21 shows a loss of 3,416,203 Euro, a different picture of performance for the same period would be shown if the 2013 financial statements were based on the Euro accounts as in this latter case the net income would be a profit of 6,189,956 Euro (see the P&L Account reported in table 9, column named "Based on EUR accounts")[202].

The main reason for such a strong divergence in the recorded earnings lays down the fact that in the course of 2013 Hold.Co borrowed a loan in USD that was repaid in the same financial year. This transaction is treated on a different manner depending on whether IAS 21 is applied or not. In particular,

- under IAS 21 the US dollar is designated as functional currency for Hold.Co. Hence, in the USD accounts, no exchange gain or loss arises as the debt was recorded in USD on Hold.Co's books (at the date of transaction) and repaid in the same currency;
- by contrast, if the functional currency criteria are not applied and the Euro is the currency for both accounting and reporting purposes, a different picture would be shown in the annual

[202] Recall that in this latter case the accounting records are kept in Euro thus assuming that the functional currency criteria have been ignored. Hence, in this case there is no analysis on the functional currency choice, nor it is necessary to apply the translation procedure stated by IAS 21 to translate the accounts from the functional currency to the presentation currency.

accounts. In this case, in fact, the USD loan is treated as a foreign currency transaction and as such, it is subject to fluctuation in the translation rate between the date of transaction and the payment date of the loan. In particular, in 2013 it was registered a depreciation of the USD dollar that led to a decrease in the Euro equivalents of the USD amounts. As the USD loan was fully repaid by Hold.Co in the same financial year in which the debt was accounted for, Hold.Co recorded a realized gain due to the depreciation of USD against EUR[203]. This realized (or settled) transaction creates a real gain that was reflected immediately in the 2013 income.

In addition to the above, it is worth noting that what appear in the income statement prepared under IAS 21 are those foreign exchange differences that derive from translating foreign currency transactions into the functional currency (USD)[204]. In the case of Hold.Co, this difference is a net gain of 796,092 Euro[205].

Further differences exist in the balance sheet items. In particular, the value of the participation into Op.Co translated under the IAS 21 procedure (current rate method, i.e. at year-end) is lower of more than 10 million compared to that in the euro-based accounts (temporal method, i.e. at historical exchange rate). This is due to the depreciation of the USD dollar, registered in late 2013, that led to a decrease in the Euro equivalents of the USD amounts. The same effect and reasoning are valid for the intangible assets, even if with minor impacts in their values.

---

[203] More in detail, when Hold.Co borrowed the USD loan, the foreign exchange rate was around 1 EUR = 1,32 USD' while as at the date of settlement (November 2013) the exchange rate was around '1 EUR = 1,38 USD'.

[204] See comments explained in par. 5.1 of Chapter Two.

[205] This amount results from the difference between the exchange gain of 1,018,461 Euro and the exchange loss of 222,369 Euro (see table 9) and includes both the exchange differences resulting in settled transactions (realized exchange differences) and those arising in the translation of year-end receivables and payables (unrealized exchange differences).

Another issue that has affected the Hold.Co balance sheet under IAS 21 was the exchange loss that resulted from the translation from the USD functional currency to the presentation currency (Euro) as prescribed by IAS 21. In fact, foreign currency translation adjustments arising from such translation procedure do not appear in the income statement as these are shown in the net equity of Hold.Co as comprehensive loss in accordance with IAS 21 (see the balance sheet in table 9, line "Exchange reserve IAS 21" amounting to 1,527 million Euro)[206].

Table 10 shows the main differences in reporting outcomes – as illustrated above – and gives a picture of the relevant effects that the applications of IAS 21 has on the Hold.Co's financial statements.

Table 10. Hold.Co – Effects of IAS 21 on financial statements

Hold.Co – Item (values in Euro)	**Financial Statements IAS 21 (currently presented)**	**Financial Statements Euro-based**
Net exchange gain (loss)	796,092	10,400,833
Net income (loss)	(3,416,203)	6,189,956
Exchange reserve IAS 21 (net equity item)	(1.527.497)	-

A similar analysis was conducted for Op.Co, the results of which are reported in table 11.

Table 11. Op.Co – Effects of IAS 21 on financial statements

Op.Co – Item (values in Euro)	**Financial Statements IAS 21 (currently presented)**	**Financial Statements Euro-based**
Net exchange gain (loss)	8,191	(246)
Net income (loss)	(598,610)	(610,311)

[206] Recall that according to IAS 21 (par. 41), these exchange differences are not recognized in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations.

Exchange reserve IAS 21 (net equity item)	(4,711,675)	-

As it appears from the table above, the sole relevant divergence is the exchange loss that results from the translation procedure required under IAS 21 to convert the USD balances (functional currency) into Euro (presentation currency). In fact, a foreign currency translation adjustment of 4,711,675 Euro arises from such translation procedure. This translation adjustment does not affect the income for the period as it is shown in the net equity of Op.Co – and not in the income statement – in accordance with IAS 21.

Moreover, table 11 attests that there are no significant differences in the foreign currency translation results arisen in the two sets of financial statements. This was basically due to the fact that Op.Co did not borrow money, nor it has other monetary items in a currency different from its functional currency (USD) – as occurred for Hold.Co – and thus no exchange gain or loss on foreign currency loan would have arisen in the financial statements based on Euro accounts.

In light of the study findings on the effects of compliance with IAS 21 requirements, it emerges that, in principle, there could be significant impacts in the performance earnings when the functional currency criteria are applied by Italian companies. As shown in the case study at hand, the implications of adhering to IAS 21 may be reflected not only in the foreign exchange adjustments recorded in the P&L account (due to the floating of exchange rates that affect monetary items) but also in the value of the assets and net equity of firms.

The findings of this work are consistent with the body of literature that support the view that foreign currency translation methods (current rate method vs. temporal method) affect the financial results of firms: the present work is helpful in this respect as it confirms that the temporal method resulted in financial statements that, in one way or another, did not reflect economic reality that IAS 21 requirements aims to achieve.

Less clear is the relationship between the functional currency choice and the evidence of opportunism in managers' behaviour. Whilst a body of literature asserts the existence of managerial opportunism in currency translation methods preferences[207], results of this study do not fully address this conclusion. The reason for this seems to lie in the circumstance that managers' compensations may be linked to several accounting variables such as, among others, those net accruals-based, cash-flows based and gross vs. net measures[208]. In this sense, by the experience of the present study, it could be concluded that when managers' bonus are linked to net accruals-based measures (e.g. earnings), firms that have – or predict to have – a strong debt exposure in foreign currency may be more likely to use the temporal method of translation in periods of depreciation of that foreign currency. Conversely, where managers performance is based on returns or cash flows measures (e.g. operating cash flow), their bonus plans should not in principle be affected by the methods of translation and thus by the functional currency chosen.

8.2. Tax implications of the functional currency approach.

The analysis covered in previous paragraphs suggests that the functional currency approach required by IAS 21 may in some cases provide noticeably different foreign currency translation results if compared to those cases in which this approach is ignored.

As the relationship between accounting income and taxable income is very close in Italy, this divergence may also be reflected in the area of corporate income taxes. This is because under the Italian tax law the taxable

[207] See par. 7 in Chapter Two.
[208] For a discussion on this topic, see among others, Y. HUANG, N. LI, J. NG, *Performance Measures in CEO Annual Bonus Contracts*, Paper June 2013.

income (tax loss) is quantified starting from the result of the income statement and it is to this result that increasing/decreasing adjustments provided for by the Italian tax law are to be made[209].

By examining the two P&L accounts reported in table 9 (above) for Hold.Co, it appears clearly that where the functional currency approach laid down in IAS 21 is not applied (see column named "Based on EUR accounts"), the profit before tax is heavily influenced by the foreign currency translation gains (Euro 16,478,948) that arise from the repayment of the USD loan. As this exchange difference represents a realized gain, it will be relevant for tax purposes in accordance with the Italian tax rules. Thus, in this case, this exchange difference has an immediate effect on the taxation for the period.

A different picture is delineated in the case of P&L account prepared under IAS 21, as shown in the mentioned table (see table 9, column named "Based on IAS 21"). In this latter case, in fact, the (realized) exchange difference related to the settlement of the USD loan does not exist in the accounts of Hold.Co: the foreign exchange differences recorded in this P&L account derive from translating foreign currency transactions (such as those denominated in euro) into the functional currency (USD), under the provisions of IAS 21.

By contrast, in the case of financial statements based on IAS 21, an exchange differences arise from the translation from the functional currency (USD) into the presentation currency (Euro) for the purpose of preparing and filing the separate financial statements: this difference does not affect current earnings as they are not accrued as income/loss. In this respect, it must be recalled that IAS 21 expressly provides that these exchange differences are not

[209] This principle – also known as "reinforced derivation" principle of the taxable base from the statutory income/loss – is governed by Art. 83, paragraph 1, of the ITC and provides that the result of the P&L account represents the "starting point" for the quantification of the taxable base. This principle applies (or it is even reinforced) also for IAS adopters for which the criteria as to the qualification, timing of accrual and classification in the financial statement provided by the IAS/IFRS principles are respected also for corporate income tax purposes (see Art. 83, paragraph 1, of the ITC).

recognised in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. Hence, in the view of IAS 21, the exchanges differences at hand are not of a "business nature" and as a consequence, under the "reinforced derivation" principle stated by Italian law, they should not be even relevant for tax purposes[210].

It must be clarified that this point has received limited attention of the national tax regulators and hence to date, no specific tax rules or instructions of the Italian Tax Authority exist that confirm the tax treatment of the foreign exchange adjustments deriving from the translation procedure at hand. Given the general importance of complying with IAS/IFRS, the national regulators in Italy should introduce specific tax provisions to aid understanding and clarity for Italian firms in applying the functional currency approach, in order to increase the extent of compliance with IAS/IFRS disclosure requirements and corporate transparency.

Meanwhile, based on the considerations made in this study, it could be concluded that exchange differences arising from this translation procedure (and accrued to reserves in the net equity) are ignored in calculating the taxable profit/loss as the effective to-be-taxed wealth of a certain company is measured in that functional currency.

9. Contribution of this work.

The present study has examined some research questions and hypothesis that have been raised in previous studies in the field of foreign currency translation accounting methods. The empirical findings of this work offer a significant contribution to knowledge for a number of reasons.

[210] For the sake of clarity, it must be noted that as at today, this point has not been expressly clarified by law or by instructions from the competent tax authorities.

Firstly, to the best knowledge of the author, this is one of the first studies – and likely the first in its kind – that examines the IAS/IFRS requirements on foreign currency issues and studies the extent of disclosure and compliance with IAS 21 requirements in annual reports for Italian companies. In this regard, this study has found that a rigorous adherence to the functional currency criteria ruled by IAS 21 may provide a different picture of companies' performance if compared to those cases in which those criteria are ignored.

Secondly, this work contributes to the extant international accounting literature to provide evidence of the impacts of the use of temporal method of translation versus the current rate method on the reporting earnings. In this sense, it offers knowledge of just what happens to separate financial statements when the entities' accounts are expressed in a currency designated under the criteria set forth by IAS 21 and then translated by the methodology of IAS 21 (current rate method).

Thirdly, this work examines the impacts of country legal constrains (at country level) on the extent of compliance with IAS 21 and, in particular, with the functional currency approach prescribed by IAS/IFRS. In particular, it confirms that national legal restrictions existing in the selection of the currency for accounting purposes lead firms to ignore the factors prescribed by IAS 21 to assure a true and fair view of their real and effective wealth: this may reasonably lead to incorrect inferences drawn from the results.

In addition, this study also examines the effects on taxation for Italian IAS adopter of applying the functional currency approach and its relevant criteria stated by IAS 21 when the selected functional currency differs from the presentation currency required by Italian law for financial statements purposes. In this regard, this work highlights that a lack in the current Italian tax legislation exists for cases as that here examined. More in detail, the investigation made through this study in the field of corporate income taxation leads to conclude that, to avoid uncertainty, normative criteria should be offered to govern the tax relevance of those exchanges differences that arise from the translation from the functional currency into the presentation currency for the purpose of preparing and filing the separate financial statements of an entity.

10. A critique of this work.

As with any piece of research, this work is subject to several limitations. Clearly, it is impossible for a sole study to cover all aspects of foreign currency matters and assure a full understanding of accounting measures of foreign exchange exposure. Thus, this study is open to criticism at a number of levels.

The purpose of this section is to inform those who might wish to duplicate or extend this work by highlighting strengths and weaknesses of this study.

The strengths of this work lay in the depth of insight that the methodology chosen made possible. As a qualitative study, it allowed exploration of untested aspects of the accounting for foreign currency translation for IAS adopters, especially in the Italian scenario. The analysis at hand was unusual, by current practice, in choosing to cover an aspect of foreign exchange issues in accounting that is not familiar for Italian firms due to local normative constrains. The decision to carry out this study by this methodology was important to expound reasons and effects of the functional currency approach chosen by the IASB and thus to make a novel contribution to knowledge.

Conversely, the weakness found in methodology was that the applicability of these findings and conclusions beyond this work is questionable. In fact, in the absence of a sampling of a sufficient variety of cases, there is a limitation of generalizing the findings of this work for different industries and businesses. This aspect could however be addressed by further researches, as suggested later.

A further weakness may be the industry sector choice. The Oil & Gas sector is probably the typical sector that is normally affected by foreign exchange floating as the primary good sold in this market – the oil – is quoted in USD. Hence, it may also be worth analyzing whether the findings of this work could be replicated and confirmed by other sectors.

11. Suggestions for further researches.

The present research was designed to both develop theory as well as to test theory in the field of accounting for foreign currency transactions. In principle, works that attempt both theory building and theory testing at the same time is necessarily compromised to some degree in the way in which it addresses both needs. Hence, neither the theory building nor the theory testing aspects of this work can be said to conclusive and not amenable to further testing or building.

There are many opportunity for further researches.

First of all, this study uses a case study in one single country, that is Italy. Thus, researchers could extend the study to more countries in Europe to investigate in depth, by a case study methodology, the extent of compliance with IAS/IFRS in different countries and namely with the functional currency approach required by IAS 21. This analysis could also lead to study the instruments that the different local jurisdictions use to manage foreign exchange risks for local companies.

Second, this study looked at the effects of compliance with IAS 21 requirements through the observed case study. Further researches may include an empirical study to test, on a worldwide basis, how managers determine their functional currencies and what factors are normally used in such decisions.

Third, the current work considered only the effects of compliance with the functional currency approach set forth by IAS/IFRS in the Oil & Gas sector. A similar exercise could be carried out for other sectors, also in other countries, to allow us to develop an understanding on the way in which the underlying purpose that that the functional currency concept is aimed at achieving may in practice impact the international economy.

CONCLUSIONS

This thesis has explored the effects of IAS/IFRS adoption on the foreign exchange exposure of Italian companies and on their financial reporting quality.

The first important conclusion of this work relates to the recognition of the functional currency approach required by IAS 21 within the Italian context. In this regard, the study findings show that a rigorous adherence to the functional currency criteria ruled by IAS 21 affects the foreign currency translation method and hence the financial results of Italian companies.

Although the extant literatures on foreign currency translation provide mixed evidences on the effects of exchange rate adjustments on firms reported earnings, the findings of this work are consistent with that body of literature supporting the view that foreign currency translation methods (current rate method vs. temporal method) affect the financial results of firms. In this sense, the author provides evidence that the temporal method (i.e. the translation methodology applied when euro is designated as both functional and presentation currency) resulted in financial statements that, in one way or another, did not reflect economic reality that IAS 21 requirements aim to achieve.

This leads to conclude that if a country imposes restrictions in the selection of the currency to be adopted for accounting and reporting purposes, the purpose that IAS/IFRS intend to achieve by the concept of a functional currency is actually ignored in local jurisdictions and hence a true and fair view of companies' real and effective wealth cannot *per se* be assured. Hence, Italian regulators should introduce normative criteria and/or instructions that recognize the concept of a functional currency as defined by IAS 21 and explicitly allow companies to adopt a currency other than euro if this is the currency designated under the criteria of IAS 21. Such measures could help

Italian companies to have greater certainty in accounting and also to improve their extent of compliance with IAS/IFRS.

In addition to the above conclusions, the results of this thesis do not highlight an immediate relationship between the functional currency choice and the evidence of opportunism in managers' behavior, as asserted by a body of foreign currency literature. This is because managers' compensations may be linked to several accounting variables such as, among others, those net accruals-based, cash-flows based and gross vs. net measures. Whilst in principle the earnings manipulation is difficult to assess because of the complexity and diversity of the environment in which accounting choices are made, by the experience of the present study, it could be concluded that when managers' bonus are linked to net accruals-based measures (e.g. earnings), firms that have – or predict to have – a strong debt exposure in foreign currency may be more likely to use the temporal method of translation in periods of depreciation of that foreign currency. Conversely, where managers performance is based on returns or cash flows measures (e.g. operating cash flow), their bonus plans should not in principle be affected by the methods of translation and thus by the functional currency chosen.

This thesis also demonstrates that the functional currency approach required by IAS 21 may have significant effects on the corporate taxation of Italian IAS adopters. In particular, this is the case where the functional currency selected under the criteria of IAS 21 differs from the presentation currency required by Italian law for financial statements purposes (Euro) and the translation criteria stated by IAS 21 (current rate method) are to be applied. The results of this thesis highlights that a lack in the current Italian tax legislation exists for cases as that here examined. More in detail, the investigation made through this study in the field of corporate income taxation suggests that, to avoid uncertainty, normative criteria should be offered to govern the tax relevance of those exchanges differences that arise from the translation from the functional currency into the presentation currency for the purpose of preparing and filing the separate financial statements of an entity.

REFERENCES

A.B.I. – GIURISPRUDENZA COMMERCIALE (a cura di), *IAS/IFRS*, Giuffrè, Milano, 2007.

AA.VV., *Memento Pratico Contabile 2015*, Ipsoa-Francis Lefebvre, 2015.

AA.VV., *Memento Pratico Principi contabili internazionali*, Ipsoa-Francis Lefebvre, Milano, 2014.

AA.VV., *Principi contabili internazionali 2014*, Il Sole 24 Ore, Milano, 2014.

ABATE E., ROSSI R., VIRGILIO A., *IAS/IFRS – US GAAP – Principi contabili italiani*, Egea, Milano, 2010.

ACCOUNTING STANDARD BOARD, *Amendment to FRS 23 (IAS 21) The effects of changes in foreign exchange rates – Net investment in a foreign operation*, in *Accountancy*, 2006, vol. 137, p. 87.

ACCOUNTING STANDARD BOARD, *FRS 23 (IAS 21) The effects of changes in foreign exchange rates December 2004*, in *Accountancy*, 2005, vol. 135, p. 89.

ADAMO S., *Prospettive e limiti del processo di armonizzazione contabile internazionale*, in *Rivista dei Dottori Commercialisti*, 1998, 5, p. 781.

AGGARWAL R., *FASB No. 8 and reported results for multinational operations: hazard for managers and investors*, in *Journal of Accounting Auditing and Finance*, 1978, vol. 1, p. 197-216.

AIKEN M., ARDERN D., *Choice of Translation Methods in Financial Disclosure: A Test of Compliance with Environmental Hypotheses*, in *British Accounting Review*, 2003, 35, p. 327–348.

ALBERTINAZZI G., BARONE E., *Aspetti contabili per le imprese non finanziarie dell'introduzione della moneta unica europea (euro), in www.sdabocconi.it.*

ALBERTINAZZI G., *La contabilità plurimonetaria. Ammissibilità e convenienza*, in *Rivista dei Dottori Commercialisti*, 1991, 5, p. 871.

ALFREDSON K., LEO K., PICKER R., PATER P., RADFORD J., *Applying International Accounting Standards*, Wiley Australia, Milton, Australia, 2005.

AMADUZZI A., *Conflitto ed equilibrio di interessi nel bilancio dell'impresa*, Cacucci, Bari, 1949.

AMADUZZI A., PAOLONE G., *I bilanci di esercizio delle imprese*, Utet, Torino, 1986.

AMERNIC J.H., GALVIN B.J.B., *Implementing the New Foreign Currency Rules in Canada and the United States: A Challenge to Professional Judgment*, in *International Journal of Accounting*, 1984, p. 165–180.

AMODEO D., *Ragioneria generale delle imprese*, Giannini, Napoli, 1988.

ANDREANI G., TUBELLI A., *Iscrizione in bilancio e disciplina fiscale delle poste da regolare nella valuta funzionale (diversa dall'euro)*, in *Il Fisco*, 2005, 30, p. 1–4664.

ANDREANI G., TUBELLI A., *La nuova disciplina fiscale delle poste in valuta estera: un passo avanti e uno indietro*, in *Il Fisco*, 2005, 13, p. 1–1858.

ANDREI P. (a cura di), *L'adozione degli IAS/FRS in Italia: concentrazioni aziendali e bilancio consolidato*, Giappichelli, Torino, 2006.

ANDREI P., *Il bilancio consolidato nei gruppi internazionali. Metodologie di traduzione dei bilanci espressi in moneta non di conto*, Giuffrè, Milano, 1994.

ARDUINI S., *Contabilità plurimonetaria e monomonetaria nei gruppi di imprese*, Roma, 2011.

ARNOLD J.L., HOLDER W.W., *Impact of Statement 52 on Decisions, Financial Reports and Attitudes*, Financial Executives Research Foundation, Morristown, NJ, 1986.

ARRIGONI A., *Le poste in valuta estera tra bilancio e contabilità*, in *Giurisprudenza Commerciale*, 1994, vol. 21, 2, p. 313.

AYERS F.L., *Characteristics of firms electing early adoption of SFAS 52*, in *Journal of Accounting and Economics*, 1986, vol. 8, p. 143-158.

AYRES F.L., *A Comment on Corporate Preferences for Foreign Currency Accounting Standards*, in *Journal of Accounting Research*, 1986, vol. 24, 1, p. 166.

AZZALI S. (a cura di), *Il bilancio consolidato secondo i principi contabili internazionali: problemi applicativi, soluzioni operative e potenzialità informative*, Il Sole 24 Ore, Milano, 2002.

BARTOLACCI F., *Le operazioni in valuta: aspetti contabili e di bilancio alla luce dell'introduzione dell'euro,* Sistemi Editoriali, Napoli, 2001.

BARTOV E., BODNAR G. M., *Alternative Accounting Methods, Information Asymmetry and Liquidity: Theory and Evidence*, in *The Accounting Review*, 1996, vol. 71, no. 3, p. 397-418.

BARTOV E., BODNAR G. M., *Foreign Currency Translation Reporting and the Exchange-Rate Exposure Effect*, in *Journal of International Financial Management and Accounting*, 1995, vol. 6, 2.

BARTOV E., BODNAR G. M., *Foreign Currency Translation Reporting and the Exchange-Rate Exposure Effect*, in *Journal of International Financial Management and Accounting*, 1995, vol. 6, no. 2, p. 93-114.

BARTOV E., *Foreign Currency Exposure of Multinational Firms: Accounting Measures and Market Valuation*, in *Contemporary Accounting Research*, Winter 1997, vol. 14, no. 4, p. 623-652.

BASTIA P., *La formazione del bilancio consolidato*, Clueb, Bologna, 1991.

BAZAZ M.S., SENTENEY D.L., *Value relevance of unrealized foreign currency translation gains and losses*, in *American Journal of Business*, 2001, vol. 16 Issue 2, p. 55–62.

BEAVER W.H., WOLFSON M.A., *Foreign Currency Translation Gains and Losses: What Effect Do They Have and What do They Mean?*, in *Financial Analysts Journal*, 1982, March/April, pp. 28-36.

BERG G.G., *Early versus late compliance to SFAS 52: An empirical investigation of firm characteristics and the market response*, Ph.D. Thesis, 1987, Texas A&M University.

BERGAMIN BARBATO M., *La capacità informativa dei bilanci nei gruppi di aziende*, in AA.VV., *Saggi di economia aziendale per Lino Azzini*, Giuffrè, Milano 1987.

BERTINI U., *Introduzione allo studio dei rischi nell'economia aziendale*, Cursi, Pisa, 1968.

BIANCHI L.A., *Informazione societaria e bilancio consolidato di gruppo*, Milano, 1990.

BIEL H.H.,. *Foreign Woes: Foreign Exchange Losses are Proving Costly for Many Multinationals*, 1976, in *Forbes*, vol. 1, p. 95.

BOCCHINI E., *Le scritture contabili*, in *Manuale di diritto della contabilità delle imprese*, I, Torino, 1989, p. 69.

BORIO G.F., *La stabile organizzazione*, Puntolinea, Maggioli, Rimini, 2002.

BRUNETTI G. (a cura di), *Il bilancio consolidato*, Atti del Convegno svoltosi a Venezia il 3 febbraio 1984, Cedam, Padova, 1985.

BRUNETTI G., *Le riclassificazioni delle sintesi di bilancio*, in BRUNETTI G., CODA V., FAVOTTO F., *Analisi, previsioni, simulazioni economico-finanziarie d'impresa*, Etas, Milano, 1991.

BRYANT M., SHANK J.K., *FASB 8: questioning the economic impact*, in *The Accounting Forum*, December 1977, p. 11-29.

CANTINO V., *Il rischio di cambio, tecniche di gestione e di rilevazione*, Giuffrè, Milano, 2000.

CANTORIA F.M., *Consolidation of foreign subsidiaries: revisiting SFAS 52*, in *Academy of Accounting and Financial Studies Journal*, 2011, vol. 15, Special Issue, 2.

CAO A., *Le stabili organizzazioni all'estero e la conversione in lire dei bilanci sezionali*, in *Il Fisco*, 1990, 25, p. 4066.

CAPALDO P., *La valutazione dei debiti di finanziamento a medio e lungo termine in moneta estera nel bilancio ordinario d'esercizio,* in AA.VV., *Scritti* *di Economia Aziendale per Egidio Giannessi*, vol. I, Pacini, Pisa, 1994.

CARAMIELLO C., DI LAZZARO F., FIORI G., *Indici di bilancio: strumenti per l'analisi della gestione aziendale,* Giuffrè, Milano, 2003.

CARATOZZOLO M., *Il bilancio consolidato di gruppo: profili economici e giuridici*, Giuffrè, Milano, 2002.

CASANOVA M., *Impresa e azienda*, in *Trattato di diritto civile italiano*, directed by VASSALLI F., Torino, 1974.

CASSANDRO P.E., *La valutazione delle attività e delle passività espresse in moneta estera*, in AA.VV., *Studi in onore di Ugo Caprara*, Milano, 1975, II.

CATTURI G., *Le analisi di bilancio con particolare riferimento all'aspetto finanziario della gestione*, Emmeci, Siena, 1989.

CAVAZZONI C., *La capacità informativa del bilancio IAS/IFRS*, Giappichelli, Torino, 2008.

CERIANI G., FRAZZA B., *Formazione ed interpretazione del bilancio consolidato,* Cedam, Padova, 2007.

CERÙ M., *La valutazione dei crediti e dei debiti in valuta nel bilancio di esercizio*, in *Rivista Italiana di Ragioneria e di Economia Aziendale*, marzo-aprile 1991.

CHAMBERS D., et al., *An evaluation of SFAS no. 130 comprehensive income disclosures*, in *Review of Accounting Studies*, December 2007, vol. 12, Issue 4, p. 557-593.

CODA V., BRUNETTI G., BARBATO BERGAMIN M., *Indici di bilancio e flussi finanziari*, Etas, Milano, 1974.

COLLINS D., SALATKA W., *Noisy accounting earnings signals and earnings response coefficients: the case of foreign currency accounting*, in *Contemporary Accounting Research*, 1993, vol. 10, p. 119-159.

COMMISSIONE EUROPEA, *Regolamento n. 1725/2003 della Commissione del 29 settembre 2003*, "Principio contabile Internazionale n. 29 (rivisto nella forma nel 1994): Informazioni contabili in economie iperinflazionate".

COMMISSIONE EUROPEA, *Regolamento n. 1725/2003 della Commissione del 29 settembre 2003*, "Principio contabile Internazionale n. 21 (rivisto nella sostanza nel 1993) "Effetti delle variazioni dei cambi delle valute estere".

COMMISSIONE EUROPEA, *Regolamento n. 708/2006 della Commissione dell'8 maggio 2006*, "Interpretazione IFRIC 7 Applicazione del metodo della rideterminazione ai sensi dello IAS 29 Informazioni contabili in economie iperinflazionate".

COMMISSIONE EUROPEA, *Regolamento n. 708/2006 della Commissione dell'8 maggio 2006*, "Modifiche al Principio contabile internazionale n. 21 Effetti delle variazioni dei cambi delle valute estere Investimento netto in una gestione estera".

COMOLI M., CORNO F., VIGANÒ A. (a cura di), *Il bilancio secondo gli IAS*, Giuffrè, Milano, 2006.

COSSAR L., *Attività d'impresa in valuta estera e rischio di cambio. Aspetti contabili e di bilancio*, Giuffrè, Milano, 2004.

COSTA A., *Il Bilancio consolidato e l'applicazione dei principi contabili internazionali IAS/IFRS*, Cacucci, Bari, 2007.

COTTINO G., *Diritto commerciale*, I, Padova, 1993.

D'ALESSIO L., *Le operazioni in moneta estera*, Giappichelli, Torino, 1991.

D'AMICO E., *Teorie di gruppo e tecniche contabili di formazione dei bilanci consolidati*, Cedam, Padova 1999.

D'ATTILIO C., *La contabilità plurimonetaria*, in *Amministrazione e finanza*, 1994, vol. 9, 8, p. 416.

DE CICCO R., *Il Bilancio consolidato: alcuni rilievi in merito alle teorie e alle metodologie di consolidamento*, Dipartimento di Economia e politica aziendale, Università degli Studi di Milano, Milano 2000.

DE DOMINICIS U., *Svalutazione monetaria e rendiconti d'esercizio*, Bozzi, Genova, 1976.

DEE C.C., *Comprehensive Income and Its Relation to Firm Value and Transitory Earnings*, 1999, Working Paper, Louisiana State University.

DEL GIUDICE M., *I redditi prodotti all'estero mediante stabili organizzazioni*, in *Il Fisco*, 1978, 16, p. 16.

DEZZANI F., BIANCONE P.P., BUSSO D., *IAS/IFRS*, IPSOA, Milano, 2012.

DEZZANI F., *Il bilancio consolidato e le società estere: i metodi di conversione in moneta italiana dei loro bilanci*, in AA.VV., Scritti di Economia Aziendale per Egidio Giannessi, vol. I, Pacini, Pisa, 1994.

DEZZANI F., *La contabilità multivalute. Stabile organizzazione all'estero*, in *Il Fisco*, 1988, 11, p. 1670.

DI CAGNO N., *Il bilancio consolidato di gruppo*, Cacucci, Bari, 1993.

DI RESTA G., FABIO M., *La contabilità plurimonetaria*, in *Il Fisco*, 2002, 43, p. 1–6812.

DI STEFANO G., *Il sistema delle comunicazioni economico-finanziarie nella realtà aziendale moderna*, Giuffrè, Milano, 1990.

DI TANNO T., *Le fluttuazioni del cambio nella determinazione del reddito d'impresa*, in *Rassegna tributaria*, 1983, Parte I, p. 37.

DRAGONETTI A., PIACENTINI V., SFONDRINI A., *Manuale di fiscalità internazionale*, IPSOA, Milano, 2012.

DUANGPLOY O., HELMI D., *Foreign currency hedge accounting: multi-currency versus functional currency accounting*, in *Managerial Auditing Journal*, 2000, vol. 15, 5, p. 232.

DUANGPLOY O., OWINGS G.W., *The compatibility of multicurrency accounting with functional currency accounting*, in *The International Journal of Accounting*, 1997, vol. 32, 4, p. 441.

DUANGPLOY O., *The Sensitivity of Earnings Per Share to Different Foreign Currency Translation Methods*, in *International Journal of Accounting Education and Research*, 1979, Spring, pp. 121-134.

EPSTEIN B.J, JERMAKOWICZ E.K, *IFRS 2007 – Interpretation and Application of Infernational Financial Reporting Standard*, Wiley, Hoboken, USA, 2007.

EVANS T.G., DOUPNIK T.S., *Determining the Functional Currency Under Statement 52, Stamford*, CT: FASB, 1986, p. 11–12.

FANNI M., *Le condizioni di omogeneità monetaria e d'integrità patrimoniale nella contabilità ordinaria di esercizio. Analisi in periodi di inflazione*, Del Bianco, Trieste, 1978.

FELIZIANI C., *Differenze cambio emergenti dalla conversione dei saldi delle stabili organizzazioni estere. Trattamento contabile e disciplina fiscale*, in *Il Fisco*, 1996, 3, p. 582.

FERRERO G., *Bilancio e contabilità per l'inflazione*, Giuffrè, Milano, 1977.

FERRERO G., DEZZANI F., PISONI P., PUDDU L., *Le analisi di bilancio*, Giuffrè, Milano, 1994.

FERRI G.B., *Scritture contabili* (voce), in *Enciclopedia del diritto*, XLI, Milano, 1989, p. 820.

FIELDS D.T., LYS T.Z., VINCENT L., *Empirical research on accounting choice*, in *Journal of Accounting and Economics*, vol. 31, 2001, p. 255-307.

FONDAZIONE LUCA PACIOLI, *Operazioni e poste in valuta*, Documento n. 3 del 12 gennaio 2005, Roma, 2005.

FRANCALANCIA L., *Il rischio di cambio nel bilancio consolidato di imprese multinazionali*, Sistema, Roma, 1984.

GALEOTTI M., *Governo dell'azienda e indicatori di performance*, Giappichelli, Torino, 2006.

GARBARINO C., *La tassazione del reddito transnazionale*, Cedam, Padova, 1990.

GARDINI S., *Il Bilancio consolidato secondo i principi contabili nazionali e internazionali*, Giuffrè, Milano, 2010.

GIANNETTO G., *La stabile organizzazione nel sistema dell'imposizione diretta: con particolare riferimento alla stabile organizzazione all'estero di società residente in Italia*, in *Il Fisco*, 1999, 45, p. 13944.

GIUNTA F. (a cura di), *Analisi di bilancio: teoria e tecnica*, Copisteria II Prato, Firenze, 2004.

GRAY D., *Corporate Preferences for Foreign Currency Accounting Standards*, in *Journal of Accounting Research*, 1984, vol. 22, 2, p. 760.

GRIFFIN P.A., *Management's preferences for FASB statement no. 52: Predictive ability results*, in *Abacus*, 1983, vol. 19, p. 130-138.

HEALY P. M., WAHLEN J.M., *A review of the earnings management literature and its implication for standard setting*, Harvard Working Paper, 1998.

HOLT P.E., *A Normative Evaluation of Translation Methodologies Based On Present Values of Future Cash Flows to Investors*, in *Southwest Business and Economics Journal*, 2013, vol. 21, p.21-34.

HOLT P.E., *Comparative information content of return on assets based alternative translation methods*, in *Southwest Business and Economics Journal*, 2005, vol. 12, p. 9-17.

HOLT P.E., *Critical elements of foreign currency translation: a worldwide informational and accounting problem*, in *American Journal of Economics and Business Administration*, 2013, vol. 5, p. 56-64.

HOLT P.E., *Estimation of temporal characteristics of accounts for empirical research*, in *Advances in Business Research*, 2011, vol. 2, no. 1, p. 231-237.

HOLT P.E., *Some effects of alternative foreign currency translation methodologies on two short-term liquidity ratios*, in *American Journal of Economics and Business Administration*, 2011, vol. 3, p. 645-651.

HOLT P.E., *The Fischer Black Method of Evaluating Accounting Alternatives Applied to Currency Translation Methods*, in *Advances in Business Research*, 2012, vol. 3, p. 113-119.

HOLT P.E., *The variability of earnings across foreign currency translation methodologies: an empirical comparison*, in *Southwest Business and Economics Journal*, 2006, p. 67-81.

HOSSEINI A., SHALCHI H., *A multivariate analysis of the determinants of the functional currency dichotomy decisions*, in *Global Finance Journal*, 1992, vol.3, 1, p. 51.

HOYLE J.B., SCHAEFER T.F., DOUPNIK T.S., *Advanced Accounting*, Sixt edition, McGraw-Hill, New York, 2001.

HUANG Y., LI N., NG J., *Performance Measures in CEO Annual Bonus Contracts*, Paper June 2013.

IANNIELLO G., *Moneta di conto e moneta estera nell'informazione contabile*, Cedam, Padova, 2001.

IATRIDIS G., JOSEPH N., *A conceptual framework of accounting policy choice under SSAP 20*, in *Managerial Auditing Journal*, 2005, vol. 20, p. 763-778.

IATRIDIS G., JOSEPH N., *Characteristics of UK firms related to timing of adoption of Statement of Standard accounting practice No. 20*, in *Accounting and Finance*, 2006, vol. 46, p. 429-455.

IJIRI Y., *Segment statements and informativeness measures: managing capital vs managing resources*, in *Accounting Horizons*, 1995, p. 55-67.

INVERNIZZI G., MOLTENI M., *Analisi di bilancio e diagnosi strategica*, Etas, Milano, 1990.

JAEGER P.G., *Accounting harmonization within the EEC*, in *Rivista del diritto commerciale*, 1992, I, p. 261-266.

KAWALLER I.G., *Hedging currency exposures by multinationals: things to consider*, in *Journal of Applied Finance*, Spring/Summer 2008.

KELLY L., C*orporate management lobbying on FAS No. 8: Some further evidence*, in *Journal of Accounting Research*, 1985, vol. 23, p. 619-632.

KIRSCH R.J., EVANS T.G., *The Implementation of FAS 52: Did the Foreign Currency Approach Prevail?*, in *International Journal of Accounting*, 1994, 29, no. 1, p. 20–33.

KWON T.H., et al., *Do foreign investors price foreign exchange risk differently?*, in *Journal of Financial Research*, 2005, vol. 28, Issue 4, p. 555-573.

LACCHINI M., TREQUATTRINI R., *Ascesa e declino del principio di prudenza nel sistema contabile italiano: riflessioni critiche*, in *Rivista Italiana di Ragioneria e di Economia Aziendale*, luglio-agosto 2002.

LAGHI E., *L'armonizzazione contabile via IAS/IFRS. Prime riflessioni sull'evoluzione della disciplina in materia di bilancio delle società*, Giappichelli, Torino, 2006.

LEO M., *Le imposte sui redditi nel Testo Unico*, Tomo II, Giuffrè, Milano, 2014.

LIU J., *On International Accounting Valuation*, in *Journal of International Accounting Research*, 2006, vol. 5, p. 67-87.

LOUIS H., *The value relevance of the foreign translation adjustment*, in *Accounting Review*, October 2003, vol. 78, Issue 4, p. 1027-1047.

MARCHI L., *Economia dei gruppi e bilancio consolidato: una interpretazione degli andamenti economici e finanziari*, Giappichelli, Torino, 2004.

MASINI C., *Lavoro e risparmio*, Utet, Torino, 1987.

MASQUELIER F., *Centralization of foreign exchange risks under IAS: problems of netting foreign exchange risks at the level of treasury centres*, in *Treasury Affairs*, 2005, vol. 1, 3, p. 17.

MASSARI L., *Il bilancio di gruppo nella proposta modificata di VII Direttiva CEE*, Cacucci, Bari, 1979.

MATACENA A., TIEGHI M., *Dal bilancio d'esercizio alle analisi di bilancio: le riclassificazioni, gli indici ed i flussi*, in MATACENA A., TIEGHI M., *Il bilancio d'esercizio*, Clueb, Bologna, 1997.

MAYR S., SANTACROCE B., *La stabile organizzazione delle imprese industriali e commerciali*, IPSOA, Milano, 2013.

MECHELLI A., *Il rendiconto finanziario consolidato: profili teorici e comportamenti aziendali*, Cedam, Padova, 2008.

MEHTA D.R., THAPA S.B., *FAS 52, Functional Currency, and the Non-Comparability of Financial Reports*, in *International Journal of Accounting*, 1991, 26, no. 2, p. 71–84.

MELLA P., *Contabilità plurimonetaria. Metodi di sviluppo nelle aziende divise*, in *Contabilità e Bilancio*, 1987, 25, p. 45.

MELLA P., *Contabilità plurimonetaria. Un esempio*, in *Contabilità e Bilancio*, 1987, 26, p. 58.

MELLA P., *Il bilancio consolidato*, Isedi, Milano, 1985.

MIRZA, A. A., ORELL, M., HOLT, G. J., *IFRS: Practical Implementation Guide and Work Book*, Second Edition, John, Wiley & Sons, New Jersey, 2008.

MONTRONE A., *Il Bilancio consolidato. Evoluzione normativa e metodologia di redazione*, Franco Angeli, Milano 2004.

MOONITZ M., *Consolidated Statements*, in WIXON R., KELL W.G., BEDFORD N. M., *Accountant's Handbook*, Ronald, New York, 1970.

NASI R., *Problematiche contabili-fiscali delle stabili organizzazioni all'estero*, in *Corriere Tributario*, 1990, 37, p. 2571.

NAVARRINI U., *Trattato elementare di diritto commerciale*, II, Torino, 1935.

NIGRO A., *Imprese commerciali e imprese soggette a registrazione*, in *Tratt. dir. priv.*, directed by P. Rescigno, XV, Torino, 2001, p. 717.

NIGRO A., *Libri e scritture contabili* (voce), in *Enc. giur. Treccani*, XIX, Roma, 1990, p. 2.

NOBES C., *International Variations in IFRS Adoption and Practice*, The Association of Chartered Certified Accountants, London, 2011.

NOBES C., PARKER R., *Comparative International Accounting*, fourth edition, Prentice Hall, New York, 1995.

OCSE, *Model Convention with respect to taxes on income and on capital*, in www.ircdec.it.

ONESTI T., *"Fattori ambientali" e comportamenti contabili*, Giappichelli, Torino, 1995.

ONIDA P., *Il bilancio d'esercizio nelle imprese e la sua «standardizzazione» e «certificazione»*, in *Problemi societari e fiscali di attualità,* Scritti in memoria di L. Antonelli, Milano, 1974.

ONIDA P., *Il bilancio d'esercizio nelle imprese,* Giuffrè, Milano, 1974.

ONIDA P., *La logica e il sistema delle rilevazioni quantitative d'azienda*, seconda edizione, Giuffrè, Milano, 1970.

ORGANISMO ITALIANO DI CONTABILITÀ, *Guida operativa per la transizione ai principi contabili internazionali (IAS/IFRS),* Il Sole 24 Ore, Milano, 2005.

ORGANISMO ITALIANO DI CONTABILITÀ, *Guide operative IAS/IFRS*, Il Sole 24 Ore, Milano, 2008.

ORGANISMO ITALIANO DI CONTABILITÀ, *Principi contabili del Consiglio Nazionale dei Dottori Commercialisti e del Consiglio Nazionale dei Ragionieri modificati dall'OIC in relazione alla riforma del diritto societario, Il bilancio consolidato*, Roma, 16 settembre 2005.

ORGANISMO ITALIANO DI CONTABILITÀ, *Principi contabili del Consiglio Nazionale dei Dottori Commercialisti e del Consiglio Nazionale dei Ragionieri modificati dall'OIC in relazione alla riforma del diritto societario, Operazioni e partite in moneta estera,* Roma, 30 maggio 2005.

ORGANISMO ITALIANO DI CONTABILITÀ, *Principi contabili, Bilancio consolidato e metodo del patrimonio netto*, Roma, agosto 2014.

ORGANISMO ITALIANO DI CONTABILITÀ, *Principi contabili, Operazioni, attività e passività in valuta estera*, Roma, agosto 2014.

PAGANELLI O., *Il bilancio di esercizio in periodi di svalutazione monetaria*, in AA.VV., *Studi di Ragioneria, Organizzazione e Tecnica Economica*, Cursi, Pisa, 1975.

PAGANELLI O., *Il bilancio di gruppo. Significato economico e procedimenti di formazione*, Azzoguidi, Bologna, 1978.

PALMA A. (a cura di), *Il bilancio di esercizio e il bilancio consolidato*, Giuffrè, Milano, 1996.

PANUCCIO V., *La natura giuridica delle registrazioni contabili*, Napoli, 1964.

PAOLONE G., D'AMICO L., TRESCA R., *Le rilevazioni contabili nei gruppi societari*, Cacucci, Bari, 1998.

PAOLONI M., *Il bilancio d'esercizio in una prospettiva nazionale e internazionale*, Giappichelli, Torino, 2006.

PARIS A., *La traduzione dei bilanci delle affiliate estere: un'indagine sullo "stato dell'arte" nei Paesi dell'Europa Occidentale*, in *Rivista Italiana di Ragioneria e di Economia Aziendale*, settembre-ottobre 1994.

PARIS A., *La traduzione dei bilanci delle affiliate estere: un'indagine del divario tra principi contabili e prassi contabile verificabile nei Paesi dell'Europa Occidentale*, in *Rivista Italiana di ragioneria e di Economia Aziendale*, novembre-dicembre 1994.

PARKER L.D., *Qualitative Research in Accounting and Management: the Emerging Agenda*, in *Journal of Accounting and Finance*, 2003, no. 2, pp. 15-39.

PAUSENBERGER E., ROTH A., *Störfaktoren im internationalen Controlling*, Zeitschrift für betriebswirtschaftliche Forschung, 1997.

PELLICELLI G., *La contabilità indicizzata (contabilità adeguata al livello dei prezzi). Una tecnica per decidere meglio e per presentare bilanci più chiari*, in *Rivista dei Dottori Commercialisti*, 3, 1977.

PIAZZA M., *Guida alla fiscalità internazionale*, Il Sole 24 Ore, Milano, 2004.

PIAZZA M., *Imprese italiane all'estero ed estere in Italia*, Pirola, Milano, 1987.

PINTO, J.A.M., *Foreign Currency Translation Method Choice: Insights from Game Theory*, in *The Journal of Applied Business Research*, 2002, vol. 18, n. 4, p. 25.

PINTO, J.A.M., *How Comprehensive is Comprehensive Income? The Value Relevance of Foreign Currency Translation Adjustments*, in *Journal of International Financial Management & Accounting*, 2005, vol. 16, no. 2, p. 97-122.

PISONI P., *Il bilancio consolidato IAS/IFRS*, Giuffrè, Milano, 2007.

PISONI P., *Il primo bilancio redatto secondo gli IAS/IFRS*, Egea, Milano, 2007.

PIZZO L., *L'area di consolidamento dei bilanci di gruppo*, Cedam, Padova, 1983.

PIZZO M., *L'adozione degli IAS/IFRS in Italia*, Giappichelli, Torino, 2006.

PODDIGHE F. (a cura di), *Analisi di bilancio per indici*, Cedam, Padova, 2004.

POLI P.M.., *Functional currency: effects on earnings and the market*, in *Journal of International Business Studies*, 1996, vol. 27, 2, p. 436.

PORPORA F., STANCATI G., *Si può tenere la contabilità in lingua straniera?*, in *Dialoghi di diritto tributario*, anno I, 2, p. 291.

PORTER G.A., *Foreign currency accounting FAS 8 or 52? multinationals experiment*, in *Massachusetts CPA Review*, Summer 1983, p. 48-54.

POTITO L., *La rilevazione dei risultati d'impresa in periodi di inflazione*, in AA.VV. *Studi in Onore di Pietro Onida*, Giuffrè, Milano, 1981.

POZZOLI M., *Elementi di international accounting*, Il Sole 24 Ore, Milano, 2001.

PRENCIPE A., TETTAMANZI P., *Il bilancio consolidato secondo i principi internazionali: tecniche di redazione e di analisi*, Egea, Milano, 2004.

PRICEWATERHOUSECOOPERS (PWC), *Principi contabili internazionali. Interpretazioni e confronti con i principi contabili nazionali*, IPSOA, Milano, 2015.

PRINCIPIO CONTABILE INTERNAZIONALE N. 21 – *Effetti delle variazioni dei cambi delle valute estere*.

PROVASOLI A. (a cura di), *La IV e la VII Direttiva CEE nel progetto di attuazione*, in *Rivista dei Dottori Commercialisti*, Supplemento, 5, settembre-ottobre 1988.

PWC, *Foreign currency*, 2014, p. 3-3.

RAHMAN M.M., MONIRUZZAMAN M., SHARIF M.J., *Techniques, Motives and Controls of Earnings Management*, in *International Journal of Information Technology and Business Management*, 29th March 2013. vol.11, No.1.

RANALLI F., *Sulla capacità informativa delle strutture di bilancio*, Cedam, Padova, 1984.

RASHTY J., *Foreign Currency Matters. New Guidance for Derecognition of Cumulative Translation Adjustments*, in *The CPA Journal*, March 2014, p. 54.

RATCLIFFE T.A., MUNTER P., *Currency translation: a new blueprint*, in *Journal of Accountancy*, June 1982.

RAYBURN F.R., CROOCH G.M., *Currency translation and the funds statement: a new approach*, in *Journal of Accountancy*, October 1983, p. 51.

RECKERS P.M.J., TAYLOR M.E., *FASB No 8. Does it Distort financial statements*, in *The CPA Journal*, August 1978, p. 31-34.

RIJA M., *Comunicazione economico-finanziaria, bilancio consolidato e adozione degli IAS/IFRS nei gruppi aziendali. Analisi teorica e riscontri empirici*, Franco Angeli, Milano 2010.

RINALDI L. (a cura di), *Il bilancio consolidato: novità dei principi contabili nazionali e internazionali*, Il Sole 24 Ore, Milano, 2008.

ROMAN L.W., *Quality of Earnings and Earnings Management, in Journal of*

AICPA, 2009.

RONNER A., BLOK M., *Hedging foreign currency exposure: consequences of FAS 133*, in *Journal of Applied Finance*, Spring/Summer 2001.

ROSSI RAGAZZI F., *Problemi fiscali e di bilancio delle stabili organizzazioni all'estero*, in *Consulenza*, 1987, 11.

RUPP G.L., *A simulation study of alternative methods for translating statements of autonomous foreign entities*, Unpublished Ph.D. Dissertation, 1982, Oklahoma State University.

SAITA M., CAMPEDELLI B., *Il bilancio di esercizio e consolidato*, Giuffrè, Milano, 1997.

SARCONE S., *I gruppi aziendali. Strutture e bilanci consolidati*, Giappichelli, Torino, 1993.

SAUDAGARAN, SHAHROKH M, *International Accounting: A User Perspective*, 2nd edition, Thompson South-Western, 2004.

SAVIOLI G., *Il bilancio di esercizio secondo i principi contabili nazionali e internazionali*, Giuffrè, Milano, 2004.

SELLING T.I., SORTER G.H., *FASB Statement No. 52 and Its Implications for Financial Statement Analysis*, in *Financial Analysts Journal*, 1983, vol. 39, p. 64-69.

SIEGFRIED M., SANTACROCE B., *La stabile organizzazione delle imprese industriali e commerciali*, IPSOA, Milano, 2013.

SOLIMENE S., *Il bilancio consolidato e il bilancio separato. Principio contabile internazionale n. 27; Le partecipazioni in società collegate. Principio contabile Internazionale n. 28; Le partecipazioni in joint venture. Principio contabile internazionale n. 31*, in G. ZANDA, *Il bilancio delle società. Lineamenti teorici e modelli di redazione*, Giappichelli, Torino, 2007.

SOO B.S., SOO L.G., *Accounting for the multinational firm: is the translation process valued by the stock market?*, in *The Accounting Review*, 1994, vol. 69, no. 4, p. 617-637.

SPENCER S.L., RICHARDS G.E., *Three common currency-adjustment pitfalls*, in *Journal of Accountancy*, 2012, vol. 213, 2, p. 30.

SUPERTI FURGA F., *Le ragioni del bilancio di gruppo*, in *Le Società*, 4, 1985.

TANG R.T.W., *Foreign currency translation information reported by Fortune 500 companies*, in *Journal of Corporate Accounting and Finance*, Spring 1995, vol. 6, p. 67.

TEODORI C., *Il bilancio consolidato: la metodologia di costruzione e il profilo informativo*, Giuffrè, Milano, 2003.

TERZANI S., *Il bilancio consolidato*, Cedam, Padova, 1990.

TERZANI S., *Il bilancio per l'inflazione: considerazioni critiche*, Tipografia La Porziuncola, S. Maria degli Angeli, 1978.

TESSITORE A., *Riflessi dell'inflazione sul bilancio d'esercizio*, in AA.VV., *Studi in Onore di Pietro Onida*, Giuffrè, Milano, 1981.

TETTAMANZI P., *Principi contabili internazionali*, Pearson Paravia Mondadori, 2008.

TEZZON M., *La disciplina del bilancio consolidato. Prassi e problemi applicativi*, Giuffrè, Milano, 1994.

TOGNOLO P., *La stabile organizzazione*, Il Sole 24 Ore, Milano, 2004.

TRUMBULL M., WATSON K., *Qualitative Research Methods*, in *Integrating Quantitative and Qualitative Methods in Research*, 3th Edition, 2010, University Press of America.

TUTINO F., *Il controllo di gestione dei rischi di cambio nelle imprese e nei gruppi aziendali*, in Banche e Banchieri, 1, 1989.

TUTINO M., *Bilancio d'esercizio, operazioni complesse e patrimonio netto*, Cedam, Padova, 2012.

Various authors, *International GAAP 2007*, Lexis-Nexis, London, 2006.

VIVANTE C., *Trattato di diritto commerciale*, I, Milano, 1928.

WALLMAN S. M. H., *The future of accounting and disclosure in an evolving world: the need for dramatic change*, in *Accounting Horizons*, 1995, p. 81-91.

WANG Y., et al., *The value relevance of dirty surplus accounting flows in the Netherlands*, in *International Journal of Accounting*, 2006, vol. 41, Issue 4, p. 387-405.

WATTS R.L., ZIMMERMAN J.L., *Positive Accounting Theory: A Ten Year Perspective*, in *The Accounting Review*, 1990, vol. 65, no. 1, p. 131-156.

WEINBERGER M., *U.K. tax rules on functional currency significantly liberalized*, in *Tax Adviser*, 2001, vol. 32, 1, p. 18.

ZAMBON S. (a cura di) *Informazione societaria e nuovi processi di armonizzazione internazionale*, Il Mulino, Bologna, 2002.

ZANDA G., *Il bilancio delle società. Lineamenti teorici e modelli di redazione*, Giappichelli, Torino, 2007.

ZANDA G., *Il governo della grande impresa nella società della conoscenza*, Giappichelli, Torino, 2009.

ZANDA G., *La valutazione dei dirigenti*, Cedam, Padova, 1984.

ZANDA G., LACCHINI M., *Rivalutazione di beni aziendali ed utilizzo di poste del patrimonio netto*, Giappichelli, Torino, 1993.

ZAPPA G., *Il reddito di impresa*, Giuffrè, Milano, 1937.

ZAROWIN S., *The future of finance*, in *Journal of Accountancy*, 1995, p. 47-49.

ZIEBART D.A., KIM, D.H., *An examination of the market reactions associated with SFAS no. 8 and SFAS no. 52*, in *Accounting Review*, April 1987, p. 343-357.

ZIZZO G., *Regole generali sulla determinazione del reddito d'impresa*, in AA. VV., IRPEF, in *Giur. Sist. Tesauro*, II, Torino, 1994.