P&A Grant Thornton

Insights into PFRS 18

Foreign exchange differences



Introduction

PFRS 18 'Presentation and Disclosure in Financial Statements' (PFRS 18 or the Standard) becomes mandatorily effective for periods beginning on or after 1 January 2027, with earlier application permitted. It requires retrospective restatement of prior period comparative figures. The International Accounting Standards Board (IASB) introduced IFRS 18 following investor demand for better information and reporting on entities' financial performance. Once adopted locally, this will be known as PFRS 18, the Standard replaces PAS 1 'Presentation of Financial Statements', and sets out the requirements for the presentation of information in the financial statements and disclosure in the notes, with the aim of improving comparability across entities and assisting investors in analysing company performance.

Our 'Insights into PFRS 18' series explains the new requirements of PFRS 18, highlighting some areas of the Standard that we believe will be challenging to apply in practice. Our articles also aim to help users of PFRS financial statements to understand how financial statements will change when applying the new Standard.

As we discussed in our article '**Insights into PFRS 18 – Classification of income and expenses in the statement of profit or loss**', one of the most significant changes is in the classification of income and expenses. PFRS 18 introduces a principles-based framework that requires entities to classify items based on the nature of the underlying asset, liability, transaction, or event – not the nature of the income or expense itself. This has specific impacts on gains and losses that arise due to changes in foreign exchange rates.

This article provides insights into the application of the requirements of PFRS 18 to the classification of income and expenses arising from foreign exchange differences.

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General classification requirements

PFRS 18 has very specific requirements for classifying foreign exchange differences.

PFRS 18's general classification requirement is for the foreign exchange differences arising from the application of PAS 21 'The Effects of Changes in Foreign Exchange Rates' to follow the classification of the income and expenses from the items that gave rise to them, eg foreign exchange differences on a foreign-currency denominated receivable for the sale of goods are classified in the operating category, because the sale of goods is classified in the operating category.

In the absence of specific classification requirements in PAS 1, entities have historically applied different approaches to the presentation of foreign exchange gains and losses, resulting in significant diversity in practice. In developing PFRS 18 the IASB decided that specific classification requirements for the foreign exchange differences were necessary to achieve faithful presentation of an entity's business activities.

We will now consider how these requirements may be applied in different scenarios. The examples included in this publication relate to entities that do not invest in assets or provide financing as their main business activity. For detailed guidance on the relevance of specified main business activities please see our article '**Insights into PFRS 18 – Classification of income and expenses in the statement of profit or loss**'.



Example 1 – Change in classification of the foreign exchange differences on transition to PFRS 18

Entity A is a manufacturer of electric appliances.

Under PAS 1, Entity A's accounting policy is to present all foreign exchange gains and losses on a net basis within a single line item, 'Net foreign exchange gain/(loss)'. This line item is presented by Entity A below the 'Finance costs' line in the statement of profit or loss.

As part of the transition to PFRS 18, Entity A must assess whether any changes are required to the classification of foreign exchange differences within the statement of profit or loss.

Analysis

On transition to PFRS 18, entities are required to analyse the transactions and balances which give rise to the foreign exchange gains or losses. Entity A analysed its 'Net foreign exchange loss' of CU 650,000 for the financial year 20X6 as follows:

Transactions and balances that give rise to the foreign exchange differences	Foreign exchange gain/(loss) CU	PFRS 18 classification of the foreign exchange gain/(loss)	Rationale
Sale of electric appliances to foreign wholesale customers and resulting foreign currency denominated trade receivables	(270,000)	Operating category	PFRS 18 requires entities to classify foreign exchange differences in the same category as the income or expenses from the items that give rise to such foreign exchange differences. Revenue from sale of the electric appliances shall be classified by Entity A in the operating category. Foreign exchange loss on retranslation of the foreign currency denominated trade receivables must be classified in the same category, ie in the operating category.
Foreign currency denominated loan receivable from Entity A's associate	140,000	Investing category	A loan receivable from an associate is an asset that generates returns independently of Entity A's other resources. In accordance with PFRS 18, income and expenses that arise from the initial and subsequent measurement of this asset (eg interest income) are required to be classified in the investing category. Entity A must classify foreign exchange gain on retranslation of the foreign currency denominated loan receivable in the same category as income or expenses associated with this asset, ie in the investing category.
Foreign currency denominated borrowings	(520,000)	Financing category	Entity A determined that its foreign currency denominated borrowings arise from transactions that involve only the raising of finance. In accordance with PFRS 18, income and expenses that arise from the initial and subsequent measurement of such liabilities (eg interest expense) need to be classified in the financing activity. Entity A must classify foreign exchange loss on retranslation of its foreign currency denominated borrowings in the same category as any income or expenses associated with such borrowing, ie in the financing category.
Total	(650,000)		

Based on the analysis above, Entity A will have to split its 'Net foreign exchange loss' into three components and present them in the operating, investing and financing categories in line with the PFRS 18 requirements. Presentation in a single line item will no longer be permissible (unless the 'undue cost or effort' exemption applies).

Undue cost or effort – relief from the general classification requirements for foreign exchange differences

An 'undue cost or effort' exemption permits classification of affected foreign exchange differences in the **operating category** when complying with the general requirements would involve 'undue cost or effort'. This is only expected to be available in limited circumstances when the cost or effort is clearly disproportionate to the benefit.

When completing the assessment of undue cost or effort the assessment must be:

- made for each item that gives rise to foreign exchange differences, and
- specific to the facts and circumstances related to each item. Only if the same facts and circumstances relate to multiple items, can the same assessment be applied to each of those items.

If an entity is unable to allocate specific foreign exchange differences to the applicable category without undue cost or effort, the relief above applies only to those specific foreign exchange differences, not to all foreign exchange differences recognised in the statement of profit or loss.



Classification of foreign exchange differences for 'type 2 liabilities'

Our article '**Insights into PFRS 18 – Classification of income and expenses in the statement of profit or loss**' explains the concept of 'type 1' and 'type 2' liabilities introduced by PFRS 18 and how the requirements apply to each of them.

Example 1 above illustrates the classification of foreign exchange differences arising from transactions that involve only the raising of finance ('type 1 liabilities').

There is more complexity involved in determining the classification of foreign exchange gains and losses that relate to transactions that do not involve only the raising of finance ('type 2 liabilities'). This is because entities with type 2 liabilities may have to classify the associated income and expenses in more than one category. When this is the case, significant judgement may be required to determine what income or expense the foreign exchange differences relate to on each transaction, as PFRS 18 requires that the foreign exchange difference on each transaction be attributed to, and therefore classified in, only one category in the statement of profit or loss.

Foreign exchange differences that relate to a single transaction are not allowed to be allocated between several categories, even if other income and expenses associated with that transaction are classified in more than one category.

PFRS 18 does not require entities to classify the exchange differences on all type 2 liabilities in the same category, however exchange differences on similar liabilities must be classified in the same category.

The examples below illustrate application of this requirement.

Practical insight – Classification of foreign exchange differences for type 2 liabilities

PFRS 18 establishes principles for classification of foreign exchange differences arising from type 2 liabilities but lacks definitive guidance. We expect entities to apply judgement based on specific facts and circumstances of their transactions. When the foreign exchange differences associated with the type 2 liabilities are material, the financial statements should include sufficient disclosure of the significant judgements made.

In the absence of detailed guidance in PFRS 18, this is an area to watch as practice develops.

"Foreign exchange differences that relate to a single transaction are not allowed to be allocated between several categories, even if other income and expenses associated with that transaction are classified in more than one category."

Classification of foreign exchange differences on foreign currency denominated payables with extended credit terms

Type 2 liabilities is a broad category that includes liabilities with different levels of complexity. The most common example of a type 2 liability that many entities would have is trade payables.

In accordance with PFRS 18, interest income and interest expense arising from type 2 liabilities are classified in the financing category only when such interest is separately identified in accordance with PFRS Accounting Standards. In practice, entities do not ordinarily recognise interest on trade payables. While trade payables contain an element of financing, typically it is not significant to be accounted for separately, unless the payable is on extended credit terms.

If an interest expense on a foreign currency denominated payable is identified, entities should consider implications on classification of the foreign exchange differences.



Example 2 – Classification of foreign exchange differences on foreign currency denominated payable with extended credit terms

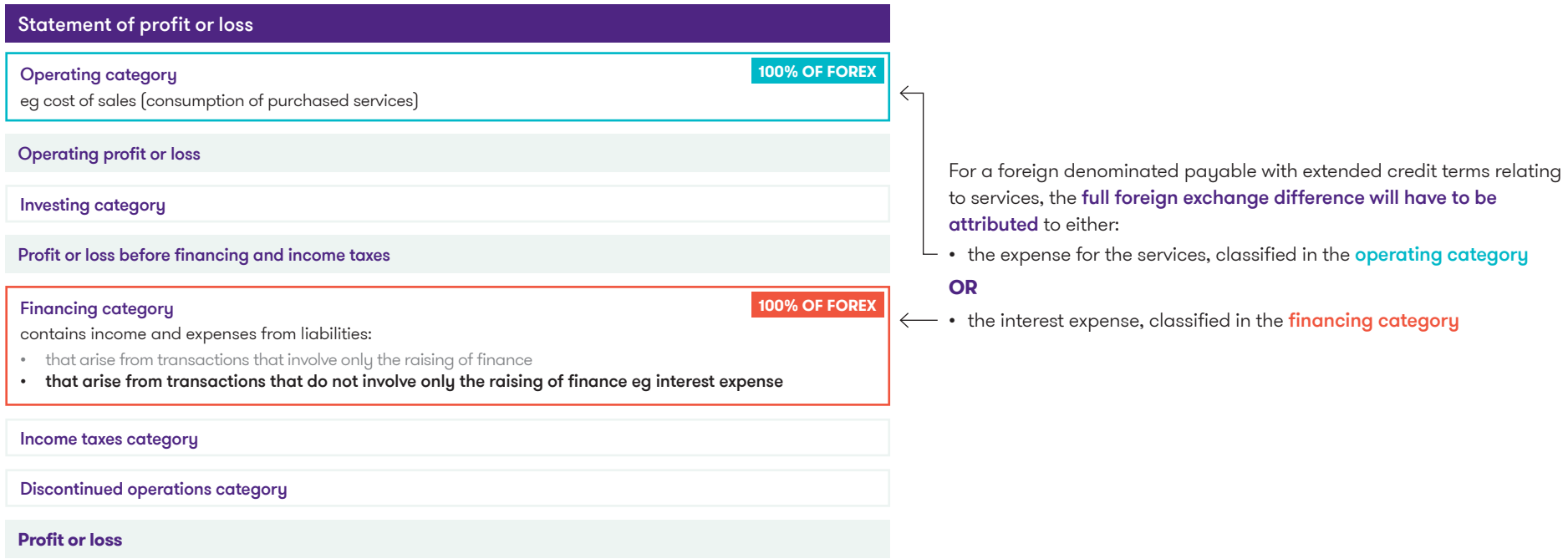
Entity B has a foreign currency denominated payable with extended credit terms, relating to the purchase of services.

Which category within the statement of profit or loss should Entity B classify the foreign exchange difference arising from this payable?

Analysis

Entity B classifies the expenses relating to these services in more than one category – the expense recognised for the purchased services being classified in the operating category, and interest expense on the payable being classified in the financing category.

Given that PFRS 18 does not allow foreign exchange differences that relate to a single transaction to be allocated between several categories, Entity B will need to exercise judgement to determine which expense the foreign exchange difference relates to. The potential alternatives available to Entity B are illustrated in the diagram below:



Entity B in applying its judgement must consider its specific facts and circumstances to determine the most appropriate classification of the foreign exchange differences. The judgement should be consistently applied to all similar type 2 liabilities.

Classification of foreign exchange differences on short-term payables for the purchase of an asset that generates returns individually and largely independently

In accordance with PFRS 18, income and expenses from assets that generate returns individually and largely independently of other resources shall be classified in the investing category. These assets typically include debt or equity investments and investment properties (along with the receivables for rent, generated by these properties). Assets that do not generate returns individually or largely independently from an entity's other resources include those that are used in combination to produce or supply goods. They typically include items of property, plant and equipment; receivables for goods and services used in production or supply; and loans where the entity provides financing to customers as a specified main business activity.

When an entity purchases an asset that generates returns individually and largely independently of its other resources, a question arises as to where to present the foreign exchange difference arising from any short-term payable in respect of this purchase. Consider the following example:



Example 3 – Classification of foreign exchange differences on short-term payables for the purchase of an asset that generates returns individually and largely independently

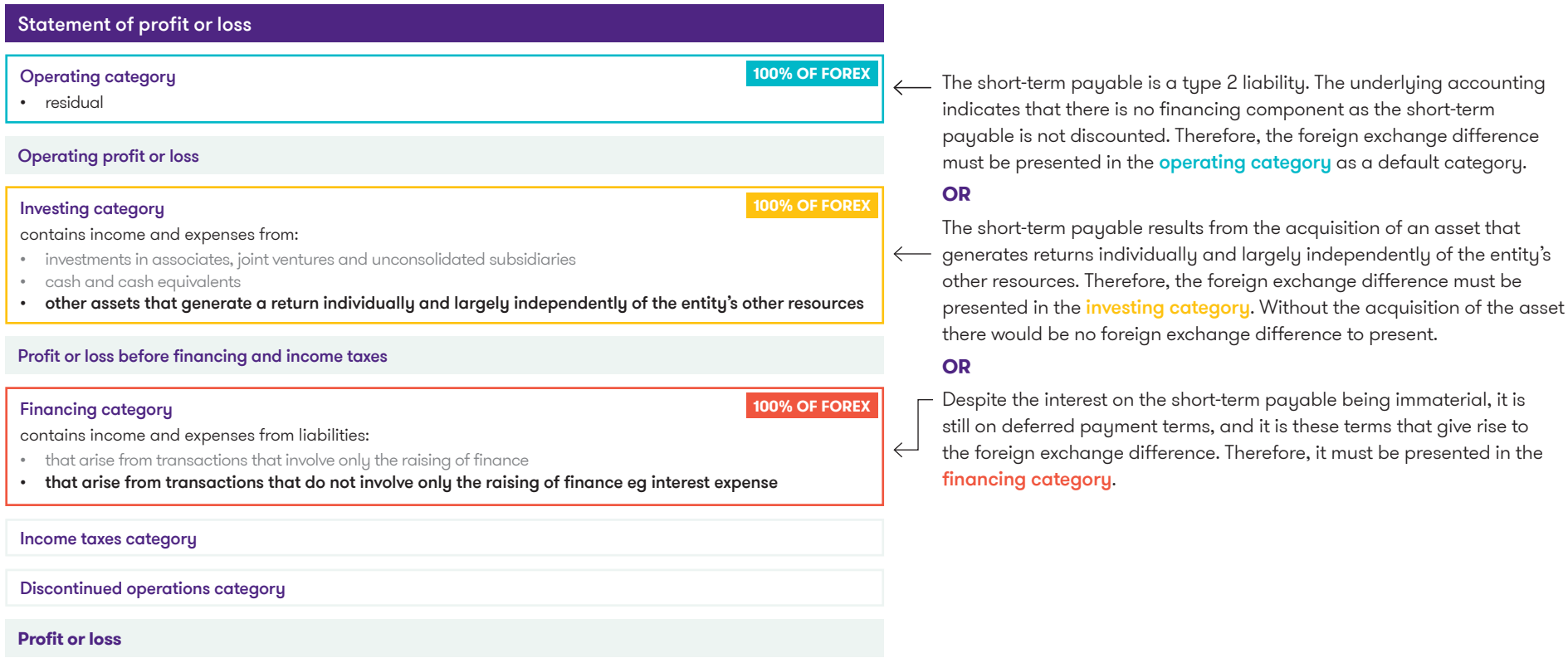
Entity C's functional currency is GBP, and it has a year end of 31 December. It does not invest in assets or provide financing to customers as its main business activity. It purchased an asset in USD that generates returns individually and largely independently of its other resources on 20 November 20X5. It will pay USD 1,000 for the purchase, with payment due on 31 January 20X6. The effect of discounting is immaterial as the liability is short-term in nature. No interest expense is recorded for this liability.

Which category within the statement of profit or loss should Entity C classify the foreign exchange difference arising from the short-term payable?

Analysis

The answer to this question requires careful consideration.

Entity C has potential alternatives for classification of the foreign exchange differences arising from the short-term payable associated with purchase of an asset that generates returns individually and largely independently of other resources. These are explained in the diagram below:



As PFRS 18 does not specifically address this scenario, there is scope for Entity C to exercise judgement based on the specific facts and circumstances of the transaction in question. When the foreign exchange differences are material, the financial statements should include sufficient disclosure of the significant judgements made.

Classification of foreign exchange differences on foreign currency denominated leases

A lease liability is another example of a transaction that does not involve only the raising of finance, ie a type 2 liability. Entering into a lease transaction results in the recognition of a lease liability and a right-of-use asset. The lease liability incurs interest expense whereas the right-of-use asset is depreciated. As a result, the associated income and expenses from the transaction are classified across more than one category of the statement of profit or loss. This leads to the question of which category any associated foreign exchange difference should be recognised in.



Example 4 – Classification of foreign exchange differences on foreign currency denominated leases

Entity P's functional currency is GBP and it enters into a lease contract for an item of property, plant and equipment denominated in USD. The recognised right-of-use asset is not an asset that is capable of generating returns individually and largely independently from Entity P's other resources.

Which category within the statement of profit or loss should Entity P classify the foreign exchange difference arising from the foreign currency denominated lease arrangement?

Analysis

Considering the requirements of PFRS 18, the investing category is not appropriate in this situation as the right-of-use asset is not capable of generating returns individually and largely independently from Entity P's other resources. The potential alternatives that might be considered by Entity P for classifying the foreign exchange difference are demonstrated in the illustration below:

Statement of profit or loss

Operating category — 100% OF FOREX
- residual

Operating profit or loss

Investing category
contains income and expenses from:
- investments in associates, joint ventures and unconsolidated subsidiaries
- cash and cash equivalents
- other assets that generate a return individually and largely independently of the entity's other resources

Profit or loss before financing and income taxes

Financing category — 100% OF FOREX
contains income and expenses from liabilities:
- that arise from transactions that involve only the raising of finance
- **that arise from transactions that do not involve only the raising of finance eg interest expense**

Income taxes category

Discontinued operations category

Profit or loss

Considering the whole lease transaction, an entity will:
a) recognise and depreciate a right-of-use asset, and
b) recognise a lease liability and associated interest expense.

Both the depreciation and interest expense should be considered when categorising the associated foreign exchange difference. Judgement should be made to assess whether the transaction arises from the purchase decision to acquire an asset (operating category) or from a financing decision (financing category). Any foreign exchange difference should then be classified accordingly.

OR

The right-of-use asset is irrelevant in this assessment. The lease liability is a type 2 liability, meaning the interest expense is presented in the financing category. The foreign exchange difference must also be presented in the financing category.

Given the absence of definitive guidance in PFRS 18 regarding the classification of foreign exchange differences on foreign currency denominated leases, it is our view that the ultimate presentation of the gain or loss will require the application of judgement based on the specific facts and circumstances of the transaction in question.

Classification of foreign exchange differences on intercompany loans

In April 2026, the IFRS Interpretations Committee (IFRIC) published an agenda decision on the classification of the foreign exchange difference from an intragroup monetary liability or asset. It addressed the question of how to categorise a foreign exchange gain or loss in the consolidated financial statements when the underlying balance that gave rise to the difference has been eliminated. The agenda decision confirmed that there were two acceptable approaches to presenting these exchange differences. These approaches are explained in the following example.



Example 5 – Classification of foreign exchange differences on intercompany loans

Parent X owns 100% of Subsidiary Z to which it has loaned USD 2 million. Parent X has a functional currency of CAD and Subsidiary Z has a functional currency of USD. Neither entity has a main business activity of providing financing to customers or investing in financial assets. The USD 2 million loan does not form part of Parent X's net investment in Subsidiary Z. Parent X recognises a foreign exchange difference in its individual financial statements reflecting the translation of the USD loan receivable into its functional currency of CAD. However, on consolidation the intercompany loan is eliminated, but in accordance with the requirements of PAS 21, the exchange difference in the financial statements of Parent X is not.

How should the exchange difference be presented in the consolidated financial statements of Parent X when the intercompany loan it is related to has been eliminated on consolidation?

Analysis

The April 2026 IFRIC agenda decision confirmed that either of the following approaches are acceptable in this situation:

Operating category	Same category as the parent / subsidiary prior to elimination unless there is undue cost or effort
PFRS 18 states that foreign exchange gains and losses should be presented in the same category as the income and expenses of the items that gave rise to the difference. Parent X cannot apply this requirement because the intercompany loan balances and associated income and expenses, other than the foreign exchange gain and loss, are eliminated on consolidation. Therefore, the foreign exchange differences should be presented in the operating category as this is the residual category for those items that do not meet the requirements to be presented in the financing or investing categories.	This approach requires an assessment of each intercompany financing transaction that falls into the loan and how they are classified in the separate financial statements of the group entity recognising the foreign exchange difference. Parent X has provided the loan to Subsidiary Z, meaning it presents its interest income from the loan in the investing category. Therefore, on consolidation, the remaining foreign exchange difference is also presented in the investing category. Conversely, if the loan was in CAD, Subsidiary Z would recognise the foreign exchange difference. It would categorise any interest expense in the financing category in its separate financial statements. Therefore, this classification would follow through to the consolidated statements when the underlying transaction is eliminated. The undue cost and effort exemption of presenting in the operating category remains available for more complex intercompany transactions.

On preparation of the group financial statements, management should make an accounting policy choice and apply it consistently to similar transactions.

Practical insight – Classification of foreign exchange differences on intercompany loans

The aforementioned IFRIC agenda decision provides entities with two options to present foreign exchange differences on intercompany loans that are eliminated on consolidation. Importantly, the agenda decision illustrates that for certain scenarios there may be more than one acceptable approach for classification of the foreign exchange differences. This could lead to diversity in practice. As mentioned previously, when the foreign exchange differences are material, the financial statements should include sufficient disclosure of the significant judgements made to provide transparency and context behind management's decision against the background of the IFRIC agenda decision.

How we can help

We hope you find the information in this article helpful in giving you some insight into aspects of PFRS 18. If you would like to discuss any of the points raised, please contact and visit **https://www.grantthornton.com.ph/Contact/.**

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