Republic of the Philippines
SECURITIES AND EXCHANGE COMMISSION
SEC Building, EDSA, Greenhills
Mandaluyong City

SEC Memorandum Circular No. 14
Series of 2003

RE: GUIDELINES ON PREPARATION OF FUNCTIONAL CURRENCY FINANCIAL STATEMENTS

SECTION 1. Policy Statement

Companies whose transactions are substantially denominated in a currency other than Philippine pesos have stated that the use of Philippine pesos results in foreign exchange gains (losses) which may distort their financial condition and performance. In response to the clamor of these companies which have invested in the Philippine economy, the Commission is issuing this Memorandum Circular for the guidance of the companies concerned. The BIR has issued rulings allowing qualified entities to use US Dollars and Japanese Yen in presenting their financial statements (FS). In addition, the Philippines is moving towards the adoption of International Financial Reporting Standards (IFRS), formerly known as International Accounting Standards (IAS), in accordance with the globalization of financial reporting structures. IFRS recognizes the concept of functional currency which may be different from the currency of the country in which the company is domiciled.

SECTION 2. Definition of Terms Under this Circular

1. **Functional currency** – the currency of the primary economic environment in which the entity operates; normally, that is the currency of the environment in which an entity primarily generates and expends cash. The functional currency of an entity is, in principle, a matter of fact. The functional currency is equivalent to the measurement currency which is defined simply as the currency used by an entity for measuring items in its financial statements.

2. **Foreign Currency** – a currency which is other than the functional currency of the qualified entity. For purposes of this Circular, the Philippine peso will be considered as a foreign currency if it is not the functional currency of the qualified entity

3. **Commission** – refers to the Securities and Exchange Commission

4. **BIR** – refers to the Bureau of Internal Revenue

5. **Qualified entity**- a corporation or entity which meets the criteria specified under Section 3 of this circular

SECTION 3. Scope

This Memorandum Circular can be availed of and used primarily by corporations or entities whose revenues and, cost and expenses denominated in its functional currency represent at least 70% of the respective total amounts. The 70% threshold is a presumptive level in determining the functional currency of an entity, subject to the provisions of Section 4 below. Any entity which has previously qualified under this rule but which may subsequently fall below this 70% threshold may justify its retention under this rule with the Commission.

SECTION 4. Determination of Functional Currency

A qualified entity shall consider the following primary factors in determining its functional currency:

1. The currency:
   (a) That mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled).
   (b) Of the country whose competitive forces and regulations mainly determine the sales price of its goods and services).

2. The currency that mainly influences labor, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

The following factors may also provide additional supporting evidence to determine a company's functional currency:

1. The currency in which funds from financing activities (i.e., issuing debt and equity instruments) are generated.
2. The currency in which receipts from operating activities are usually retained.

The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the company that has the foreign operation as its subsidiary, branch associate or joint venture):

1. Whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy.
2. Whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.
3. Whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
4. Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

In cases when the above indicators are mixed and the functional currency is not obvious, management uses its judgment as to which is the dominant currency to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and circumstances. A company's functional currency reflects the underlying transactions, events and circumstances that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a substantial change in those underlying transactions, events and circumstances.

For purposes of this Circular, a company initially electing to use its functional currency for statutory reporting purposes must submit to the Commission an assessment that will support the determination of its functional currency based on the criteria aforementioned. Such assessment covering at least two years will follow the format shown in Annex A which shall be signed by the company's chief executive officer and chief financial officer. In addition, the company's external auditor shall issue a report to accompany the assessment following the suggested format in Annex B. The company may attach additional information and analyses that it may deem relevant The Commission reserves the right to call the attention of the entity as to the propriety of such assessment.

SECTION 5. Preparing Financial Statements in Functional Currency Other Than the Philippine Peso

A qualified entity presenting functional currency (other than the Philippine Peso) financial statements should:

1. Restate its prior year financial statements as if the company had been booking its transactions in prior years using such functional currency.

2. Treat the transactions in Philippine Peso and other currencies as foreign currency transactions for reporting purposes - For purposes of functional currency financial statements, Philippine Peso and currencies other than the functional currency are considered foreign currencies and transactions therein shall be accounted for under prevailing generally accepted accounting principles.

In relation to item 2 above, the qualified entity may opt to maintain multi-currency books of accounts to keep track of both the functional currency transactions and Philippine Peso transactions in order to facilitate reporting requirements for other regulatory bodies.

As an alternative to reconstructing the books of accounts and for first time transition to functional currency reporting, the qualified entity may translate its Philippine Peso balances to its functional currency financial statements as follows:

1. Functional currency amounts (for both balance sheet and income statement items, including capital accounts) should be specifically identified and carried over to the functional currency financial statements in their original functional currency amounts, i.e., not translated amounts. For example, assuming the determined functional currency is the U.S. dollars (USD), all accounts

denominated in USD amounts should be carried over to the functional currency financial statement without need for any translation procedures;

2. For foreign currency monetary assets and liabilities, translate using the closing spot exchange rate as of the balance sheet date;

3. Non-monetary foreign currency items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of transaction; and

4. Non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date such fair value was determined. For example, property, plant and equipment denominated in foreign currency and carried at revalued amounts shall be translated into the functional currency using the exchange rate on revaluation date.

5. Non-monetary items for which the carrying amount is determined by comparing two or more amounts, such as inventories which are carried at lower of cost or net realizable value, or the carrying amount of an asset for which there is an indication of impairment and is therefore carried at net recoverable amount, the carrying amount is determined by comparing:

   (a) The cost or carrying amount, as appropriate, translated at the exchange rate at the date that amount was determined (i.e., the rate at the date of the transaction for an item measured in terms of historical cost), and

   (b) The net realizable value or recoverable amount, as appropriate, translated at the exchange rate at the date that value was determined (i.e., the closing rate when the value was determined at the balance sheet date).

   The effect of this comparison may be that a write-down is required in the functional currency financial statements that would not be required in the Philippine Peso financial statements, or vice versa.

6. For foreign currency income and expense items recognized in the reporting period, for each period presented (i.e., including comparatives), translation should be based on exchange rates at the dates of the transactions. For practical reasons, a rate that approximates the actual exchange rates at the dates of the transactions, for example, an average rate for the period, may be used to translate foreign currency income and expense items. However, if the exchange rates fluctuate significantly, the use of the average rate for such period is inappropriate.

7. For capital accounts, the exchange rates on the dates the Philippine Peso contributions were made shall be used to translate into the functional currency financial statements. In cases where capital is allowed to be contributed in other than Philippine Peso, such original amount shall be carried over to the functional currency financial statements if the contributions were made in the entity's functional currency. If the contributions were made in other than the entity's

functional currency, then the exchange rates on the dates contributions were made shall be used to translate such amount into functional currency financial statements.

8. Any exchange differences resulting from first time presentation of functional currency financial statements shall be charged or credited to retained earnings.

9. Comparative financial statements are required to be filed.

SECTION 6. Disclosure

The qualified entity should disclose:

1. The amount of exchange differences included in net profit or loss for the period,

2. Net exchange differences charged or credited to retained earnings or any other component of owners' equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period

3. The translation rates used for major account groupings

4. The reason for using a currency different from Philippine pesos. The reason for any subsequent changes in the reporting currency should be disclosed

5. Disclosure is also encouraged about the qualified entity's foreign currency risk management policy

SECTION 7. Effectivity Clause

Qualified entities may opt to apply the provisions of this circular for annual financial statements covering periods ending on or after October 31, 2003.

Signed on behalf of the Commission on December 11, 2003, Mandaluyong City, Philippines.

LILIA R. BAUTISTA
Chairperson

Annex A

ABC Company

Determination of Functional Currency for Statutory Financial Reporting Purposes Pursuant to SEC Memorandum Circular No. _____, Series of 2003, (Guidelines on Preparation of Functional Currency Financial Statements)

For the Years Ended _____ and _____

I. Summary Information

Provide short narrative description of the currency denomination of the revenues, cost and expenses relative to the company's business operations.

A. Revenues (at least for the immediately preceding 2 years)

	Year 1		Year 2	
	In Currency	%	In Currency	%
Total Revenue per audited financial statements	xxx	xx	xxx	xx
Revenues in original currencies				
a. U.S. Dollars	xxx	xx	xxx	xx
b. Japanese Yen	xxx	xx	xxx	xx
c. Euro Dollars	xxx	xx	xxx	xx
d. Others (specify by currency)				
e.				

B. Cost and Expenses (at least for the immediately preceding 2 years)

	Year 1		Year 2	
	In Currency	%	In Currency	%
Total Cost and Expenses per audited financial statements	xxx	xx	xxx	xx
Cost and Expense in original currencies				
a. U.S. Dollars	xxx	xx	xxx	xx
b. Japanese Yen	xxx	xx	xxx	xx
c. Euro dollars	xxx	xx	xxx	xx
d. Others (specify by currency)				
e.				

II - Company Background

(Company to provide an overview of its business operations, including a discussion of matters relevant to the determination of its functional currency as enumerated in Section 4 of this Circular)

III. Detailed Supporting Schedules and Analyses in Determination of Functional Currency

[Company to add relevant support to determination of functional currency as deemed necessary. Independent auditor report can be added by reference thereto and attached to this document.]

Certified Correct by:

_____	_____
Chief Executive Officer	Chief Finance Officer

Annex B

REPORT OF FACTUAL FINDINGS

To (one who engaged the auditor)

We have performed the procedures agreed with you with respect to the revenues and cost and expenses of ABC Company for the period ended (date), set forth in the accompanying schedules. Our work is in accordance with the Philippine Standard on Auditing applicable to engagements involving agreed-upon procedures. The following *procedures were performed solely to assist you in evaluating the validity of the* revenues, cost and expenses in connection with your application with the Securities and Exchange Commission for the use of functional currency for statutory reporting:

1. (to list down agreed-upon procedures)
2.
3.
4.

We report our findings below:

a. With respect to item 1, we found ...
b. With respect to item 2, we found ...
c. With respect to item 3, we found ...
d. With respect to item 4, we found ...

(Detail the exceptions or explicitly indicate if none was found)

Because the above procedures do not constitute either an audit or a review of financial statements made in accordance with Philippine Standards on Auditing, we do not express any assurance on the revenues, cost and expenses for the year ended (date).

Had we performed additional procedures or had we performed an audit or review of the financial statements in accordance with Philippine Standards on Auditing, other matters might have come to our attention that would have been reported to you.

Our report is solely for the purpose set forth in the first paragraph of this report and for your information and is not to be used for any other purpose or to be distributed to any other parties. This report relates only to the revenues, cost and expenses and does not extend to any financial statements of ABC Company, taken as a whole.

Independent CPA

Date
Address