



VARZA SCHOOL · THE FOUNDATIONAL 100

Accounting across Currencies: Exchange Rates, Revaluation, and Exchange Differences

Chapter 32 · Track 4 — Money Accounts, Financial Statements, and Trustworthy Records

THE QUESTION IT ANSWERS

How should a business record transactions and balances when the contract currency differs from the currency of its primary economic environment?

CONCEPTS DEFINED

Functional currency · Spot exchange rate · Closing exchange rate · Exchange difference · Currency risk · Accounts receivable · Accounts payable · Nominal and real amounts

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Varza promise: clear enough for a first-time learner, exact enough for a professional conversation, and practical enough to support a real decision.

Why this chapter matters

This track turns records into statements and trust. It connects cash locations, currency, timing, measurement, reconciliation, closing, and control so that reports describe one coherent financial reality rather than separate piles of numbers.

Central question: How should a business record transactions and balances when the contract currency differs from the currency of its primary economic environment?

Foreign-currency accounting separates transaction currency, functional currency, and presentation currency. Initial recognition uses an appropriate transaction-date rate; qualifying monetary balances are retranslated at period end, and exchange differences record the changed functional-currency consequence.

Varza approaches the subject from life to ledger and from ledger to decision. We begin with what actually happened, identify the rights, obligations, resources, timing, and uncertainty, and only then choose the correct term, calculation, document, or account. This order protects the learner from a common error: learning a label without understanding the economic reality that the label is supposed to describe.

Learning outcomes

- Define and distinguish functional currency in plain and professional language.
- Define and distinguish spot exchange rate in plain and professional language.
- Define and distinguish closing exchange rate in plain and professional language.
- Define and distinguish exchange difference in plain and professional language.
- Apply the concepts to a numerical case and explain the result rather than only calculate it.
- Identify evidence, workflow, controls, and Varza entities required for reliable use.
- Recognize when jurisdiction-specific or licensed professional advice is required.

The Varza mental model

A financial concept becomes decision-ready when six questions have answers: **what, who, when, how much, based on what evidence**, and **under which assumption or rule**. A seventh question—**what should happen next**—turns knowledge into management.

This chapter uses internationally recognized terminology, but it remains jurisdiction-neutral unless explicitly stated. Accounting standards, tax rules, contract law, consumer protection, labor

requirements, and investment regulation can produce different legal outcomes in different countries. The global foundation gives the learner a stable map; local collections must add the binding rules.

Core concepts

1. Functional currency

Working definition. Functional currency is the currency of the primary economic environment in which an entity generates and expends cash, determined under the applicable framework.

Functional currency is not automatically the owner's preferred currency or the currency used for display. It follows underlying economic factors. A non-specialist can understand this by separating the object, the timing, and the consequence.

Simple example. A subsidiary invoices and pays most operating costs in one currency even though group reporting uses another.

Decision test. Who can influence the result, and who only reports it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

2. Spot exchange rate

Working definition. Spot exchange rate is the exchange rate for immediate exchange between two currencies at a specified date or time.

State the source, timestamp, direction, and convention. Buying and selling rates may differ, and accounting rules may permit practical approximations in some cases. The concept should be measured at the smallest level that still supports a real action.

Simple example. A foreign-currency purchase is initially translated using the transaction-date rate.

Decision test. Does the item affect cash now, later, or not at all? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

3. Closing exchange rate

Working definition. Closing exchange rate is the spot exchange rate at the end of a reporting period.

Monetary items denominated in foreign currency are commonly retranslated at a closing rate under applicable standards. The number alone is not enough; its definition determines whether comparisons are valid.

Simple example. A dollar payable outstanding at month-end is remeasured using the month-end rate.

Decision test. What is being measured, and what has been left outside the boundary? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

4. Exchange difference

Working definition. Exchange difference is the gain or loss arising when the same foreign-currency amount is translated or settled at different exchange rates.

Separate realized settlement effects, period-end remeasurement, and translation of foreign operations according to the applicable framework. This is where operational activity and financial reporting meet.

Simple example. A payable costs more functional currency to settle after that currency weakens.

Decision test. When did the underlying right, obligation, benefit, or sacrifice arise? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

5. Currency risk

Working definition. Currency risk is the uncertainty created when assets, liabilities, income, expenses, or commitments are exposed to exchange-rate changes.

Measure exposure by currency and timing; do not assume that all foreign-currency positions offset. In Varza language, the concept becomes useful when it changes a decision.

Simple example. A dollar payable creates risk for a business whose cash inflows are mainly in another currency.

Decision test. Which document or observation would allow another person to verify it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

6. Accounts receivable

Working definition. Accounts receivable is amounts due from customers for goods or services supplied in the ordinary course of business.

Receivables require customer-level settlement, aging, dispute status, credit monitoring, expected-loss analysis, and reconciliation to the ledger. The professional term matters because it prevents two different realities from being recorded as though they were the same.

Simple example. An issued and earned invoice remains open until paid, credited, written off, or otherwise settled.

Decision test. How would a different assumption change the result? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

7. Accounts payable

Working definition. Accounts payable is amounts owed to suppliers for goods and services received in the ordinary course of business.

Payables require supplier-level detail, due dates, disputes, approvals, credit terms, foreign currency, tax, and reconciliation. A non-specialist can understand this by separating the object, the timing, and the consequence.

Simple example. A posted supplier invoice remains open until payment, credit, offset, or other settlement.

Decision test. Who can influence the result, and who only reports it? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

8. Nominal and real amounts

Working definition. Nominal and real amounts is nominal amounts are stated in current money units, while real amounts adjust for changes in purchasing power.

Judge progress after inflation, not only by the growth of the number printed on the account. The concept should be measured at the smallest level that still supports a real action.

Simple example. An 8% nominal return with 5% inflation is roughly a 2.9% real return, not 3% exactly.

Decision test. Does the item affect cash now, later, or not at all? A reliable answer should state the unit, date or period, scope, evidence, and uncertainty. When one of these is missing, the concept may still be useful for discussion, but it is not yet decision-ready information.

How the concepts connect

The concepts in this chapter are a system, not a vocabulary list. Functional currency, Spot exchange rate, Closing exchange rate, Exchange difference, Currency risk, Accounts receivable, Accounts payable, and Nominal and real amounts describe different parts of the same decision. Confusing them usually creates one of three failures: the wrong amount is measured, the right amount is assigned to the wrong period or person, or a correct report is used for a decision it was never designed to support.

A useful analysis therefore preserves both **classification** and **relationship**. Classification tells us what an item is. Relationship tells us what caused it, what it affects, and what could change it. Varza should store both. A report that shows only totals may be suitable for orientation; a controlled decision requires traceability to the underlying relationships.

Formulas and quantitative relationships

Initial translation

Functional-currency amount = Foreign-currency amount × Transaction-date rate

The rate convention must state functional units per foreign unit or the inverse.

Boundary: The applicable framework may permit practical average rates when they approximate actual rates and exchange is not highly volatile.

Remeasurement difference

Exchange difference = Closing translated carrying amount – Pre-remeasurement functional carrying amount

The difference captures the changed functional-currency value of an open monetary item.

Boundary: Recognition location and exceptions depend on the applicable standard and item.

Worked case — A supplier payable becomes more expensive

A company whose functional currency is CU buys USD 10,000 of inventory on credit.

Item	Amount or observation
Transaction-date rate	CU 40 per USD
Initial payable	CU 400,000
Month-end rate	CU 43 per USD
Month-end payable	CU 430,000
Exchange difference	CU 30,000 loss before settlement

Calculation and reasoning

1. Record inventory and payable initially at CU 400,000, subject to eligible landed costs and tax.
2. Preserve the supplier balance as USD 10,000 in the subledger.
3. At month-end, retranslate the monetary payable to CU 430,000.
4. Recognize the CU 30,000 exchange effect according to the applicable framework.
5. When settled, compare the actual functional-currency payment with the latest carrying amount for any further difference.

What the result means

The supplier did not change the USD price, but the company now needs more functional currency to settle the same obligation. Currency risk is an economic exposure before it becomes an accounting exchange difference.

The case is deliberately compact. In practice, Varza would preserve the supporting documents, currency, dates, counterparty, project or cost center, approvals, and links to the resulting records. The lesson is not merely to reach a number; it is to make the path to that number reviewable.

Practical workflow

1. **Define the decision, responsible person, economic unit, period, and acceptable uncertainty.**
Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
2. **Determine functional currency under the applicable framework and preserve transaction currency.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
3. **Record the event using an appropriate rate and source at the transaction date.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
4. **Remeasure qualifying open monetary items at the reporting date.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
5. **Separate settlement and reporting effects and reconcile foreign and functional currency balances.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
6. **Reconcile the result to source evidence and investigate exceptions rather than forcing agreement.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
7. **Approve the decision or record at the authority level required by value, risk, and legal consequence.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.
8. **Monitor the outcome, compare it with the original assumption, and retain the learning for the next cycle.** Define the owner, required evidence, status, date, and exception route. Do not allow the next step to erase the record of the previous one.

How this concept should appear in Varza

The minimum Varza data model for this chapter includes currency, exchange_rate, rate_source, foreign_transaction, monetary_item, remeasurement, settlement, exchange_gain_loss, presentation_currency. These names are not merely interface labels. Each entity should have a stable identifier, status history, responsible owner, applicable currency or unit, effective dates, evidence links, and access controls.

A useful Varza screen should answer four questions without forcing the user to reconstruct the story manually:

1. **What happened or is expected to happen?** Show the operational event, obligation, or decision in plain language.
2. **What changed financially?** Show cash, asset, liability, equity, income, expense, commitment, or risk effects.

3. **Why should the user trust it?** Show source documents, calculations, approvals, and revision history.
4. **What requires attention now?** Show exceptions, due dates, thresholds, and the next responsible action.

The Varza design principles most relevant here are:

- Attach every important number to a source, period, currency, entity, and responsible person.
- Prefer a traceable estimate with stated assumptions to an impressive number with hidden assumptions.
- Use automation to strengthen evidence and consistency, never to remove accountability.

Varza AI may explain, classify, compare, simulate, and prepare a proposed action. It should not silently change a legal record, post a material transaction, close a period, release a payment, or make an investment decision on the user's behalf. Material actions require visible evidence, permissions, validation rules, and an accountable human approval path.

Controls and professional boundaries

1. **Approved exchange-rate sources and quote conventions.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
2. **No manual override without reason and approval.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
3. **Foreign-currency subledger reconciliation in both transaction and functional currency.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
4. **Stable definitions, versioned assumptions, and consistent units across plans, records, and reports.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
5. **Traceability from every material total to evidence, calculation, owner, and change history.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.
6. **Access and approval rights aligned with responsibility and the possible consequence of error or misuse.** The control should be proportionate to value and risk, documented clearly, and tested often enough to detect failure before the consequence becomes irreversible.

A control is effective only when it operates in practice. A policy that everyone can bypass is a statement of hope, not a control. Likewise, a control that blocks ordinary work without distinguishing low-risk and high-risk cases encourages hidden workarounds.

Common mistakes and better responses

Mistake 1: Using the payment-date rate for the original sale

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 2: Changing the historical foreign-currency amount during revaluation

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 3: Netting receivables and payables that are not legally and economically offset

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 4: Treating every currency movement as operating performance without disclosure or analysis

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 5: Using a technically correct number outside the period, entity, currency, or decision boundary for which it was calculated

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Mistake 6: Accepting an automated result without reviewing the evidence, assumptions, exceptions, and required professional judgment

Better response. Reconstruct the underlying event, state the definition being used, obtain the missing evidence, and recalculate before making a decision. Correct the process as well as the current number so the same error does not become routine.

Decision checklist

- ☐ Can I explain functional currency in plain language and in professional terms?
- ☐ Can I explain spot exchange rate in plain language and in professional terms?

- ☐ Can I explain closing exchange rate in plain language and in professional terms?
- ☐ Can I explain exchange difference in plain language and in professional terms?
- ☐ Have I stated the entity, currency or unit, date or period, and decision boundary?
- ☐ Can another person reproduce the number from retained evidence?
- ☐ Have I separated actuals, estimates, commitments, and scenarios?
- ☐ Have I tested timing, liquidity, risk, and at least one adverse outcome?
- ☐ Is the required approval proportional to the possible loss or legal consequence?
- ☐ Does the final output lead to a specific action, owner, and review date?

Practice lab

1. **Explain it.** Describe Functional currency to a person who has never studied finance. Then add the professional definition and identify one boundary your simple explanation omitted.
2. **Classify it.** Create five examples from your household or a small business and classify each using Spot exchange rate. State any assumptions.
3. **Calculate it.** Rebuild the worked case with amounts 20% higher. Identify which conclusions change and which remain structurally true.
4. **Challenge it.** Describe a situation in which Closing exchange rate could be measured correctly but still lead to a poor decision because timing, risk, or incentives were ignored.
5. **Design it.** Sketch a Varza screen or report for this chapter. Include fields, evidence links, status, owner, exceptions, and one AI-assisted action.

Answer guidance

A strong answer uses consistent definitions, reveals assumptions, distinguishes fact from estimate, and connects the result to an action. More than one conclusion may be reasonable when the learner clearly states the decision objective and uncertainty. The worked-case recalculation should preserve the method even when the numbers change.

Varza AI knowledge capsule

This capsule is intentionally explicit so that a retrieval system can distinguish canonical teaching points from examples and commentary.

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    "Closing exchange rate: the spot exchange rate at the end of a reporting period.",
    "Exchange difference: the gain or loss arising when the same foreign-currency amount is translated or settled at different exchange rates.",
    "Currency risk: the uncertainty created when assets, liabilities, income, expenses, or commitments are exposed to exchange-rate changes.",
    "Accounts receivable: amounts due from customers for goods or services supplied in the ordinary course of business.",
    "Accounts payable: amounts owed to suppliers for goods and services received in the ordinary course of business.",
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Suggested questions for Varza AI

- Explain this chapter using an example from a household, a shop, and a service business.
- Ask me five diagnostic questions before applying this concept to my situation.
- Show the difference between cash effect, accounting effect, and decision effect.
- Recalculate the worked case using my currency and assumptions, but preserve the original definitions.

- Identify which parts require local accounting, tax, legal, labor, or investment rules.

Sources and standards horizon

This chapter is original Varza educational content. It paraphrases and synthesizes concepts; it does not reproduce a standard or third-party article. The following sources were used to establish terminology, scope, and current professional context:

- **S107 — IFRS Foundation, *IAS 21 The Effects of Changes in Foreign Exchange Rates*. 2026 standards set. Functional currency, transaction translation and exchange differences. Source: <https://www.ifrs.org/issued-standards/list-of-standards/ias-21-the-effects-of-changes-in-foreign-exchange-rates/>**
- **S117 — IFRS Foundation, *IFRS for SMEs Accounting Standard*. third edition 2025; effective 2027. Simplified global reporting framework for eligible small and medium-sized entities. Source: <https://www.ifrs.org/issued-standards/ifrs-for-smes/>**
- **S118 — IFRS Foundation, *IFRS Accounting Standards—Required 2026*. 2026-01-29. Standards and amendments effective from 1 January 2026. Source: <https://www.ifrs.org/news-and-events/news/2026/01/now-available-ifrs-accounting-standards-required-2026-two-editions/>**

Standards horizon. Reviewed through 2026-08-31. IFRS 18 and the third edition of the IFRS for SMEs Accounting Standard are included as transition knowledge where relevant; both have mandatory effective dates beginning in 2027, with early application permitted under their respective requirements.

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