[SEC MEMORANDUM CIRCULAR NO. 14, S. 2003, December 11, 2003]

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 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 critieria 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