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Mr. Bruce Mackenzie
IFRS Interpretations Committee
Columbus Building
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Our ref BOD/288

24 November 2025

Dear Mr. Mackenzie

Classification of a Foreign Exchange Difference from an Intragroup Monetary Liability (or Asset) (IFRS 18)

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (the Committee's) tentative agenda decision (TAD) *Classification of a Foreign Exchange Difference from an Intragroup Monetary Liability (or Asset) (IFRS 18)*. This letter reflects the views of the KPMG network.

We welcome the Committee's efforts to address the classification of foreign exchange (FX) differences arising from intragroup monetary liabilities or assets under IFRS 18 *Presentation and Disclosure in Financial Statements*. Timely interpretation of the standard in respect of this issue is key to promoting consistent application as stakeholders implement IFRS 18.

The submission, the Committee's discussion, and the TAD highlight a lack of clarity in IFRS 18 regarding the appropriate classification of FX differences on intragroup balances. We believe that View I is technically clear because IFRS 18 defines operating as the 'default' category. However, neither the TAD nor the supporting analysis present technically compelling arguments to rule in or rule out other approaches. In particular, it is unclear how View II reconciles with IFRS 18 and how this view should be applied to the fact pattern in the submission and to other common scenarios. The Appendix to this letter sets out additional comments on View II.

We also believe that the TAD should include the technical rationale for precluding the other three views included in the submission but dismissed by the Committee.

While we think the TAD has served a useful purpose, we are concerned that the limited explanatory material is insufficient to support consistent and faithful application. We believe that if it is to be finalised, the TAD should be expanded to include substantive technical analysis, firmly rooted in the requirements of IFRS 18, and extended to address similar common scenarios.

Recommendations

We recommend that a revised agenda paper is provided to the Committee, containing an updated and comprehensive technical analysis considering all views included in the original submission. This should include an explanation and illustration of how to apply View II to the scenario in the submission and other common scenarios. We encourage such analysis to consider our comments on View II (as outlined in the Appendix) in further exploring and clarifying the technical underpinnings of View II.

The Committee should then be asked to vote on whether it agrees with the updated staff analysis and whether it believes standard-setting is required. If the Committee decides to proceed with the agenda decision, it is key that the explanatory material provides clear guidance to support consistent application.

In addition, from a process perspective, we recommend that the tied vote outcome among Committee members is addressed as part of the project to update the *Due Process Handbook*.

Please contact Brian O'Donovan at brian.odonovan@kpmgifrg.com or Agnieszka Sekita at agnieszka.sekita@kpmgifrg.com if you wish to discuss any of the issues raised in this letter.

Yours sincerely

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Appendix – Comments on View II

As noted in our cover letter, it is unclear how View II reconciles with IFRS 18 and how this view should be applied to the fact pattern in the submission and to similar common scenarios. Our concerns are explained in more detail below.

Lack of clarity on how View II reconciles with IFRS 18

The TAD refers to paragraph 45 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* and paragraph B65 of IFRS 18 as a basis for View II. However, it is unclear how View II reconciles with the wording in paragraph B65 of IFRS 18. IFRS 18 requires FX differences to be classified in the same category as the income and expenses from the items that gave rise to the exchange differences.

Paragraph 41 of IFRS 18 defines an ‘item’ for the purposes of applying IFRS 18 as an asset, liability, equity instrument or reserve, income, expense or cash flow [...]. Paragraph 45 of IAS 21 explains that the ‘monetary item’ giving rise to the FX differences ‘represents a commitment to convert one currency into another’. We do not believe that a commitment to exchange currencies is an item as described in IFRS 18. Even if the commitment to exchange currencies could be considered as the item in this context, interest income and expenses from the ‘item’ are not recognised in the consolidated financial statements.

View II appears to rely on a look-through approach (“classification based on the category in which the income and expenses from the intragroup loan would have been classified before the elimination of those income and expenses”) implying that the classification in the financial statements of the entity (the parent or the subsidiary) in which the FX differences arise is relevant. However, this approach is not consistent with the principle of assessing whether an entity has specified main business activities (SMBA) from the perspective of the reporting entity per paragraph B37 of IFRS 18. The reporting entity in the context of the TAD is the consolidated group.

We note that paragraphs 25–26 of agenda paper 2 acknowledged that [View II] is not the same as View A in the submission as “income and expenses arising from the intragroup loan might be classified differently in the separate financial statements of that entity from how those income and expenses would have been classified in the consolidated financial statements of the reporting entity”. However, neither the agenda paper nor the TAD explains how the classification of FX on the intercompany loan in the submission might differ depending on the SMBA of the reporting entity versus the SMBA of the entity (parent or subsidiary) in which the FX difference arises.

Lack of clarity on how to apply View II to the fact pattern in the submission and other common fact patterns

The TAD does not clearly explain the approach and classification outcome of applying View II in the fact pattern set out in the submission.

The TAD merely suggests that the entity should classify the FX differences in the same category in which the income and expenses from the intragroup loan would have been classified before their elimination on consolidation. However, it does not clarify which entity or category this refers to.

Intragroup monetary liabilities and assets give rise to both income and expenses in the respective counterparties in the group (e.g. an interest-bearing intragroup loan will give rise to interest expense in the borrower entity and interest income in the lender entity). It is unclear how the reporting entity should consider the income or expenses from the intragroup loan when applying View II and how it interacts with the assessment of SMBAs as discussed above.

In addition, the TAD does not address how to apply View II in other similar scenarios involving intragroup loans.

For example, intragroup loans may exist between two fellow subsidiaries within the group that result in FX differences for both subsidiaries (e.g. a EUR denominated loan between subsidiaries with USD and GBP functional currencies). In each subsidiary's separate financial statements, the income and expenses from the intragroup loan would be classified in the investing and financing categories, respectively. However, it is unclear how View II should be applied in the consolidated financial statements in this scenario – i.e. which item or category is driving the classification in the consolidated income statement.

If View II is intended to be applied based on the income statement classifications in each entity's separate financial statements, FX differences would be classified in the investing category and the financing category in the consolidated income statement, leading to the grossing up of FX differences in different categories in the income statement. We question whether such presentation would result in useful information. Without additional clarity on how to apply View II, it may create opportunities for entities to interpret the requirements in different ways to achieve a particular presentation outcome.

Similar application issues may arise in other common scenarios involving intragroup monetary liabilities and assets and more complex treasury structures (e.g. cash pooling arrangements). Given the broad scope of the TAD, it could apply to other scenarios and result in additional interpretive issues related to the application of paragraph B67 of IFRS 18.



Other comment on View II

View II in the TAD acknowledges the 'undue cost or effort' relief that may lead to the classification of FX differences in the operating category. We recommend that the TAD state that this relief is an item-by-item assessment, as per paragraph B68 of IFRS 18.