

Question 5 – Part (a)

Functional Currency of GAMA

As per LKAS 21, the determination of the functional currency is based on the currency of the primary economic environment in which the entity operates. When the entity is a foreign operation, whether the entity is merely an extension of the parent's operation should be evaluated. If so, the parent's functional currency will determine the functional currency of the entity as well. If the entity operates independently and autonomously, then the following criteria needs to be evaluated.

- 1.) Currency which influences sales price and the currency in which sales price is determined
- 2.) Currency in which majority of the expenses such as labour and material cost are incurred
- 3.) Currency in which operating cash flows are retained
- 4.) Currency in which financing is raised

Though, the entity has a foreign shareholder having a 25% ownership, Gama operates independently, and the functional currency of the foreign shareholder has no influence on the determination of the functional currency of Gama.

Therefore, Gama should be evaluated as an independent entity. The currency that influences the sales price is split evenly between USD and LKR, while majority (60%) of input cost are incurred in USD, majority (90%) of labour cost are incurred in LKR. Further, financing is raised locally as well as from foreign sources and the majority of cash flows from operating activities are retained in LKR.

Based on the above, the currency of the primary economic environment in which Gama operates can be considered to be LKR.

Requirement of the standard

Application of the requirement

Conclusion and answer

