STAFF PAPER

May 2016

Board meeting

Project	**Foreign Currency Translation**		
Paper topic	Comment letter analysis—feedback received from the Agenda Consultation process		
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Purpose

1. This paper summarises the feedback received on the research project on foreign currency translation. That feedback is derived from:

   (a) the International Accounting Standards Board's (the Board's) request for views *2015 Agenda Consultation* ('the RFV'). The RFV was published for public comment in August 2015. The comment period ended on 31 December 2015.[1]

   (b) the short online survey of investors that the Board conducted as part of its work on the RFV, to better understand their priorities with respect to financial reporting.[2]

   (c) the draft Interpretation *Foreign Currency Transactions and Advance Consideration*. The comment period ended on 19 January 2016.[3]

[1] The full analysis of the comments received on the RFV can be found in Agenda Paper 24A of March 2016.

[2] We use the term 'investor', which we broadly mean to encompass the various members of the investor community, such as asset managers, credit ratings analysts, sell-side and buy-side analysts, creditors and lenders, shareholders, etc.

[3] http://www.ifrs.org/Current-Projects/IASB-Projects/IAS-12-Measurement-income-tax-uncertain-tax-position/Draft-Interpretation-October-2015/Documents/ED_IFRIC_UncertaintyOverIncomeTaxTreatments.pdf

2. This paper provides a high-level summary of the comments received. It does not include any staff recommendations.

Structure of this paper

3. This paper is organised as follows:

   (a) background;

   (b) comments received on the Foreign Currency Translation project; and

   (c) other recent related topics discussed by the IFRS Interpretations Committee ('the Interpretations Committee').

Background

4. In this project, the Board looked at two sets of issues raised by the Korea Accounting Standards Board (KASB):

   (a) whether the accounting requirements for long-term payables and receivables denominated in a foreign currency are appropriate when the currency is volatile and thinly traded; and

   (b) whether a more comprehensive review of IAS 21 *The Effects of Changes in Foreign Exchange Rates* is needed to address some other matters raised with the Interpretations Committee and identified through the work of the KASB.

5. The Board completed its assessment work on this project in October 2014.[4] It considered the above issues and decided:

   (a) not to develop a narrow-scope amendment to IAS 21 that would apply when the currency is volatile and thinly traded;

   (b) not to pursue any of the other matters further; and

   (c) to reclassify the research project as longer-term. The Board noted that it would be helpful to have more input from the KASB and other bodies

[4] http://www.ifrs.org/Meetings/Pages/IASB-Oct-14.aspx

interested in this topic, such as other national standard-setters, and that the focus of any work by those bodies should be on the broader issues relating to IAS 21, such as performance reporting, rather than narrow-scope issues.

6. Thus the Board decided to keep the inactive project on the work plan to enable interested parties to comment on these decisions as part of the 2015 Agenda Consultation. In the RFV, the Board stated that it:

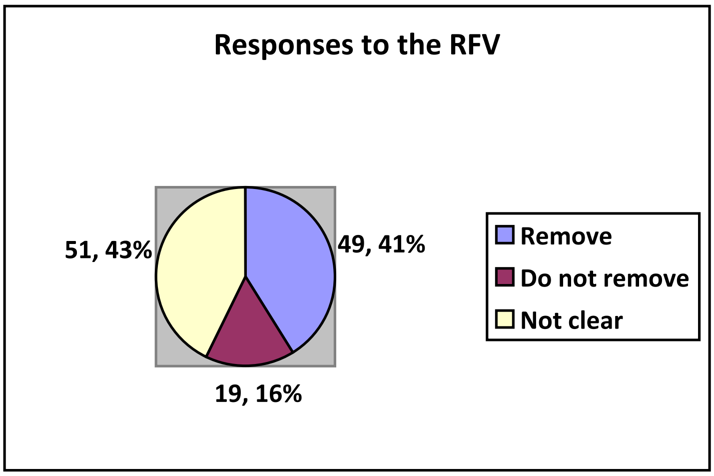
(a) had completed its assessment of this project and planned no further work at this stage; and

(b) intended to remove this projects from the research programme, unless it receives strong new evidence from the Agenda Consultation that it should reassess its decision.

Comments received on the Foreign Currency Translation project

Responses to the RFV

7. The Board received 119 comment letters in response to its RFV. 68 respondents (57%) commented on the Board's tentative decision to remove the project from the research programme. 49 (41%) explicitly supported that tentative decision, whereas 19 explicitly opposed it (16%). The other 51 (43%) respondents did not comment.



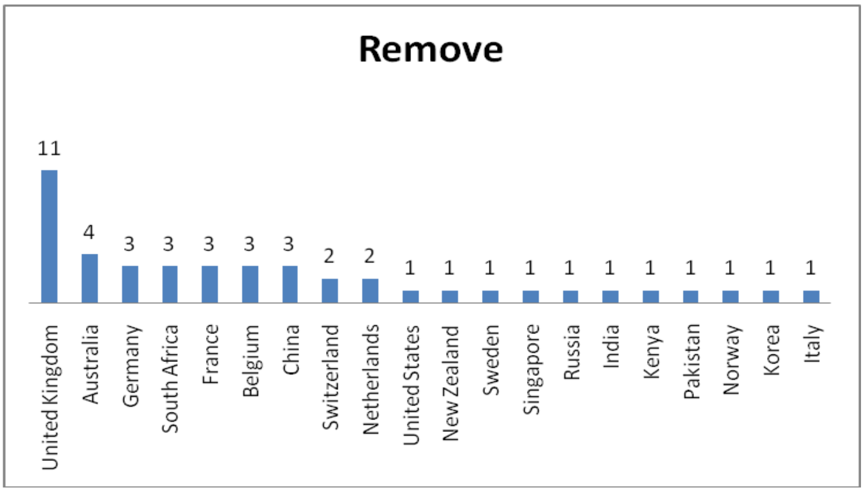
8. Most of the 49 respondents that explicitly expressed their support for the Board's tentative decision to remove the foreign currency translation project from the

research programme are accounting standard setters, accounting bodies and accounting firms, as shown in the following charts. They gave the following reasons:

(a) This issue is of limited interest and applicability. It affects only a few jurisdiction at the moment.

(b) The Interpretations Committee has been deliberating foreign currency issues in general from time to time, so the subject may warrant deeper consideration. It is likely that interpretative issues will continue to arise and the Interpretations Committee should continue to identify issues that might warrant inclusion in the Board's annual improvements programme.

(c) The project needs to address some issues. For example, using the same capitalisation method with regard to translation differences and interest. However, these are narrow-scope issues that can be addressed as part of annual improvements. Thus, the project can be removed from the research programme.



9. The 19 respondents that explicitly disagreed with the Board's tentative decision to remove the project from the research programme are mainly preparers/ preparer bodies in Europe and Japan, standard setters in Korea, Japan, Brazil, Mexico and France, and accounting bodies in Korea, Japan and United States, as shown in the following charts. Their reasons are as follows.

(a) It is better to maintain a list of such potential research projects as an aide-memoire in order to be able to reactivate them quickly if more resources become available or if a change in the economic or accounting environment leads to a rise in the priority of these projects.

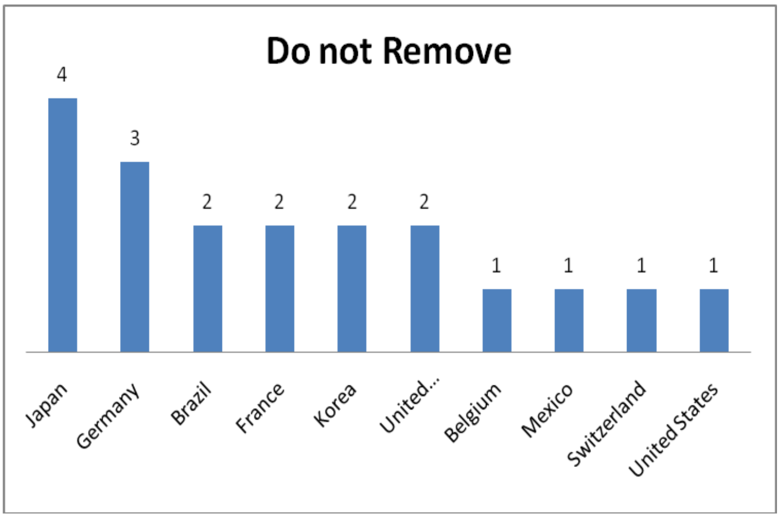
(b) The current guidance is neither consistent nor in line with risk management policies.

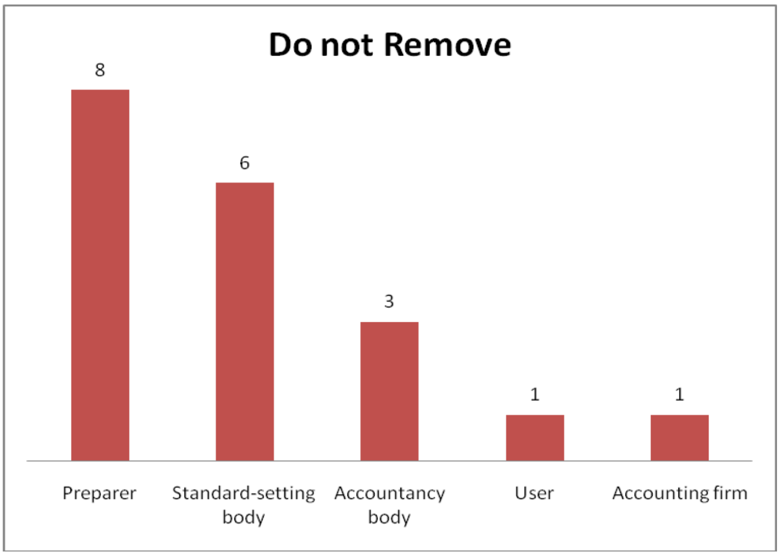
(c) Several jurisdictions, such as Korea, Japan, Brazil, Mexico and other South American countries raised some specific problems in their jurisdictions:

(i) One of the main problems in some Latin American countries is determining which exchange rates to use when exchange rates are not quoted in a free market, but rather are set by the government (existing in certain cases more than one rate) and apply to few transactions. Some governments set one more than one rate, for use in different circumstances.

(ii) The problems in countries mentioned in (i) is made more acute when hyperinflation exists in those countries. See paragraphs 10-13 for further discussion.

(iii) A few respondents recommended that the Board should make limited modifications to accounting requirements regarding determination of the functional currency. They stated that this is one of the key obstacles for particular segments of the Japanese market in considering a transition to IFRS Standards. One respondent emphasized that when an entity's functional currency is not its domestic currency, the entity's financial reporting does not reflect its internal management. Moreover, if that country's taxation and corporate laws do not permit accounting in the functional currency, the entity has to prepare ledgers in multiple currencies, bearing a substantial cost burden.





10. As mentioned in paragraph 9(c)(ii), some multinational preparers based in Europe, but with some operations in hyperinflationary economies, referred to problems that can arise from the interaction between IAS 29 *Financial Reporting in*

Hyperinflationary Economies and IAS 21. In their view, this interaction can lead to distortion that cannot be corrected solely by disclosure. One respondent stated:

> when the hyperinflationary economy also has severe exchange controls resulting in a distortion of the "official" exchange rate, this results in further challenges in applying IFRS in these circumstances. The two projects mentioned in paragraphs 39-43 of RFV did not address this interaction. This is especially an issue if the accounting impacts of inflation and exchange rate movements do not more or less compensate each other. If this is not the case, the monetary correction and reporting of revenue and expenses required to be recorded in consolidation under IAS 29 are inappropriate.' Insufficient consideration has been given to the interaction between IAS 29 and IAS 21 in certain circumstances, which can lead to distortion of information presented in the financial statements that cannot be corrected solely by disclosure.

11. The staff understands that in countries affected by this issue, hyperinflation exists. However, because of government intervention, the official exchange rate declines at irregular intervals and lags inflation by a substantial period of time. Moreover, in those countries, foreign currency is scarce and subject to central bank controls. The multinationals concerned by this issue can repatriate profits from those countries only after a lengthy delay, and only at an exchange rate that is well below the official rate that applied when the profits were earned. Official rates may be overstated by, say a factor of 5 or 10, compared with a free market rate or compared with a rate constructed by adjusting for differences in inflation. This causes two particular concerns for these preparers:

    (a) The undistributed profits earned in those countries (and surplus cash held there) are translated into the parent's reporting currency at an amount substantially above the amount that the parent can repatriate. Moreover, no mechanism exists for recognising an impairment loss in such circumstances.

    (b) In applying IAS 21, the group restates the income and expense to reflect price levels at the end of the reporting period. It then translates those amounts into the parent's reporting currency at the spot rate ruling at that date. If the official rate is overstated by a factor of 10, all income and expense will also be overstated by a factor of 10. These multinationals find it difficult to explain to both senior management and investors that an apparently large operation is, in fact, small.

12. The Interpretations Committee issued the following agenda decision on this topic in November 2014:

> The Interpretations Committee received a request for guidance on the translation and consolidation of the results and financial position of foreign operations in Venezuela. The issue arises because of strict foreign exchange controls in Venezuela. This includes the existence of several official exchange rates that may not fully reflect the local rate of hyperinflation and of restrictions over the amount of local currency that can be exchanged.
>
> Concerns were raised that using an official exchange rate to translate an entity's net investment in a foreign operation in Venezuela appeared not to appropriately reflect the financial performance and position of the foreign operation in the group's consolidated financial statements.
>
> The Interpretations Committee identified two primary accounting issues:
>
> (a) which rate should be used to translate the entity's net investment in the foreign operation when there are multiple exchange rates?
>
> (b) which rate should be used when there is a longer-term lack of exchangeability?
>
> With respect to the first issue, the Interpretations Committee observed very little diversity in the application of IAS 21 regarding the principle to use when determining which rate, out of multiple rates, to use to translate an entity's net investment in a foreign operation. The Interpretations Committee noted that predominant practice is to apply the principle in paragraph 26 of IAS 21, which gives guidance on which exchange rate to use when reporting foreign currency transactions in the functional currency when several exchange rates are available. Hence, despite the issue's widespread applicability, the Interpretations Committee decided not to take the first issue onto its agenda.
>
> With respect to the second issue, the Interpretations Committee observed that a longer-term lack of exchangeability is not

> addressed by the guidance in IAS 21, and so it is not entirely clear how IAS 21 applies in such situations. However, the Interpretations Committee thought that addressing this issue is a broader-scope project than it could address. Accordingly, the Interpretations Committee decided not to take this issue onto its agenda.
>
> However, the Interpretations Committee noted that several existing disclosure requirements in IFRS would apply when the impact of foreign exchange controls is material to understanding the entity's financial performance and position. Relevant disclosure requirements in IFRS include:
>
> (a) disclosure of significant accounting policies and significant judgements in applying those policies (paragraphs 117–124 of IAS 1);
>
> (b) disclosure of sources of estimation uncertainty that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year, which may include a sensitivity analysis (paragraphs 125–133 of IAS 1); and
>
> (c) disclosure about the nature and extent of significant restrictions on an entity's ability to access or use assets and to settle the liabilities of the group, or its joint ventures or associates (paragraphs 10, 13, 20 and 22 of IFRS 12).

13. The staff note that the agenda decision does not resolve the concerns expressed by respondents who commented in the Agenda Consultation on this topic. In addition, this topic was not discussed in the research by the KASB.

14. Paragraph 9(c)(iii) refers to some concerns expressed by respondents about determining the functional currency. Those comments appear to reflect a fundamental disagreement with the identification of the functional currency in IAS 21. In the staff's view, there is not widespread demand for the Board to reconsider that fundamental feature of IAS 21. The staff recommend no action on that topic.

Responses to the online survey

15. As part of its agenda consultation process, the Board conducted an online survey as described in Agenda Paper 24D *Online Survey: detailed responses and respondent demographics*. 109 (64%) of the 169 respondents to the online survey did not express an opinion on the foreign currency translation project. 60 (36%) of the respondents supported the Board's tentative decision to remove the project from the research programme. Half of them are users of financial statements.

Other recent related topics discussed by the Interpretations Committee

16. The Interpretations Committee published a Draft Interpretation *Foreign Currency Transactions and Advance Consideration* in October 2015. The comment period ended on 19 January 2016 and the Interpretation Committee will discuss the project in May 2016.