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STAFF PAPER

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IASB Meeting

Project	**Lack of exchangeability (IAS 21)**		
Paper topic	Transition, Early Application and Due Process		
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Introduction

1. At its April 2020 meeting, the International Accounting Standards Board (Board) tentatively decided to propose a narrow-scope amendment to IAS 21 *The Effects of Changes in Exchange Rates*. The proposed amendment would specify:
   (a) how to define exchangeability and, thus, a lack of exchangeability;
   (b) how to determine the spot exchange rate when a currency lacks exchangeability; and
   (c) disclosures required when a currency lacks exchangeability and an entity estimates the spot exchange rate.

2. The objective of this paper is to:
   (a) ask the Board whether it agrees with our recommendations on transition and early application of the proposed amendment;
   (b) set out the steps in the IFRS Foundation *Due Process Handbook* (*Due Process Handbook*) that the Board has taken in developing the proposed amendment;
   (c) ask the Board to confirm it is satisfied that it has complied with the applicable due process requirements; and
   (d) ask whether any Board member intends to dissent from the publication of the Exposure Draft.

Structure of the paper

3. This paper is structured as follows:

   (a) Background and summary of the proposed amendment (paragraphs 5-8).

   (b) Transition (paragraphs 9-30):

      (i) entities already applying IFRS Standards (paragraphs 9–22); and

      (ii) first-time adopters (paragraphs 23–30).

   (c) Effective date and early application (paragraphs 31–32).

   (d) Due Process steps and permission for balloting (paragraphs 33–37):

      (i) comment period (paragraphs 33–34);

      (ii) intention to dissent (paragraph 35);

      (iii) proposed timetable for balloting and publication (paragraph36); and

      (iv) confirmation of due process steps (paragraph37).

4. This paper includes two appendices:

   (a) Appendix A—Due process steps taken in developing the proposed amendment; and

   (b) Appendix B—Excerpts from the April 2020 IASB Update.

Background and summary of the proposed amendment

5. In response to a question submitted, the IFRS Interpretations Committee (Committee) considered how to determine the exchange rate an entity uses in particular circumstances to translate the results and financial position of a foreign operation into its presentation currency applying IAS 21 *The Effects of Changes in Exchange Rates*. The question was submitted in the light of circumstances that exist in Venezuela.

6. As part of its analysis, the Committee observed that IAS 21 does not include requirements on the exchange rate an entity uses when the spot exchange rate (as defined in IAS 21) is not observable. This arises when exchangeability between two

currencies is lacking. The Committee therefore decided to research possible narrow-scope standard-setting aimed at addressing the matter.

7. The Board discussed the matter at its November 2019 and April 2020 meetings and tentatively decided to propose a narrow-scope amendment to IAS 21 that would specify:

(a) how to define exchangeability and, thus, a lack of exchangeability;

(b) how to determine the spot exchange rate when a currency lacks exchangeability; and

(c) disclosures required when a currency lacks exchangeability and an entity estimates the spot exchange rate.

8. Appendix B to this paper reproduces excerpts from the April 2020 IASB Update summarising the Board's tentative decisions with respect to the proposed amendment.

Transition

Entities already applying IFRS Standards

9. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to retrospectively apply a change in accounting policy upon the initial application of an IFRS Standard that does not include specific transition requirements, except to the extent it is impracticable to do so.

10. Retrospective application of the proposed amendment to IAS 21 would require an entity to assess whether a currency lacked exchangeability in prior periods and then estimate spot exchange rates for those prior periods. In many cases this is likely to require the use of hindsight and, even if possible without hindsight, would be costly. We think the expected benefits of requiring entities to retrospectively apply the proposed amendment would not outweigh the costs. A lack of exchangeability is generally accompanied by high inflation and other economic events that make trend information less useful for users of financial statements (investors) than in other situations. As explained in Agenda Paper 12E of the Board's April 2020 meeting,

investors are interested in understanding an entity's exposure *at the reporting date* to a currency that lacks exchangeability.

11. Accordingly, we have considered specific transition requirements for the proposed amendment to IAS 21, considering separately situations in which an entity:

    (a) reports foreign currency transactions in its functional currency; and

    (b) uses a presentation currency other than its functional currency (or translates a foreign operation).

12. For the reasons discussed in paragraph 10 above, in both situations we propose that an entity apply the amendment from the beginning of the annual reporting period in which it first applies the amendment (date of initial application) and not restate comparative information.

Reporting foreign currency transactions in the functional currency

13. An entity applies paragraphs 20–37 of IAS 21 when it reports foreign currency transactions in its financial statements. Applying paragraph 21, an entity translates all foreign currency transactions using the spot exchange rate at the date of the transaction. Paragraph 23 of IAS 21 then states:

> At the end of each reporting period:
>
> (a) foreign currency monetary items shall be translated using the closing rate;
>
> (b) non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and
>
> (c) non-monetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was measured.

14. When an entity first applies the amendment to IAS 21, we propose that the entity:

    (a) translate foreign currency monetary items, and non-monetary items measured at fair value in a foreign currency, at the date of initial application using the estimated spot exchange rate at that date; and

(b) recognise any cumulative effect of initially applying the amendment in opening retained earnings.

15. We propose that an entity not retranslate non-monetary items measured in terms of historical cost or equity items. We acknowledge that the entity might have translated some such items using a spot exchange rate that is not aligned with the proposed amendment (if the related transactions occurred when the currency lacked exchangeability). However, in our view the expected benefits of requiring an entity to identify those items and then apply an appropriate estimated exchange rate to those items would not outweigh the cost.

Using a presentation currency other than the functional currency (or translating a foreign operation)

16. An entity applies the requirements in paragraphs 39–43 of IAS 21 when it uses a presentation currency other than its functional currency. Paragraphs 44–47 of IAS 21 apply when an entity translates the results and financial position of a foreign operation. Paragraph 44 requires the entity to also apply paragraphs 38–43 of IAS 21 in translating the foreign operation.

Entities with a non-hyperinflationary functional currency

17. Paragraph 39 of IAS 21 states:

> The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
>
> (a) assets and liabilities for each statement of financial position presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position;
>
> (b) income and expenses for each statement presenting profit or loss and other comprehensive income (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and
>
> (c) all resulting exchange differences shall be recognised in other comprehensive income.

18. When an entity's functional currency is not the currency of a hyperinflationary economy, we propose that the entity translate assets and liabilities at the date of initial application using the estimated spot exchange rate at that date, with any effect of initially applying the amendment recognised as an adjustment to the cumulative amount of translation differences in equity. We recommend this approach because an entity generally recognises exchange differences that arise when using a currency other than its functional currency (or translating a foreign operation) in other comprehensive income and accumulates those differences in a separate component of equity.

19. For reasons similar to those discussed in paragraph 15, we think an entity should not retranslate income and expenses of prior periods, even if the rate that had been applied to some of those income and expenses is not aligned with the proposed amendment.

Entities with a hyperinflationary functional currency

20. Paragraph 42 of IAS 21 states:

> The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
>
> (a) all amounts (ie assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate, at the date of the most recent statement of financial position, except that
>
> (b) when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

21. When an entity's functional currency is the currency of a hyperinflationary economy, we propose that the entity translate all assets, liabilities and equity amounts at the date of initial application using the estimated spot exchange rate at that date. Because an entity would translate all amounts using the same estimated

spot exchange rate, the application of the amendment would not result in any other adjustment.

Staff recommendation

22. We recommend that when first applying the amendment to IAS 21:

(a) an entity apply the amendment from the beginning of the annual reporting period in which it first applies the amendment (date of initial application) and does not restate comparative information.

(b) an entity that reports foreign currency transactions in its functional currency:

(i) translate foreign currency monetary items, and non-monetary items measured at fair value in a foreign currency, at the date of initial application using the estimated spot exchange rate at that date; and

(ii) recognise any effect of initially applying the amendment in opening retained earnings.

(c) an entity that uses a presentation currency other than its functional currency (or translates a foreign operation):

(i) translate all assets and liabilities at the date of initial application using the estimated spot exchange rate at that date;

(ii) translate equity items at the date of initial application using the estimated spot exchange rate at that date if the entity's functional currency is hyperinflationary; and

(iii) recognise any effect of initially applying the amendment as an adjustment to the cumulative amount of translation differences in equity.

First Time Adopters

23. We considered whether any specific exemptions from retrospective application of the amendment to IAS 21 would be required for a first-time adopter (as defined in IFRS 1 *First-time Adoption of International Financial Reporting Standards*).

Reporting foreign currency transactions in the functional currency

24. IFRS 1 does not provide any exemption for a first-time adopter that reports foreign currency transactions in its financial statements. The entity therefore applies all the applicable requirements in IAS 21 retrospectively when reporting foreign currency transactions. Accordingly, we conclude that no specific exemption is needed in respect of the proposed amendment.

Using a presentation currency other than the functional currency (or translating a foreign operation)

25. As explained in paragraphs 17 and 20 above, when an entity uses a presentation currency other than its functional currency or translates a foreign operation, the entity translates assets and liabilities using the closing rate. When the entity's functional currency is that of a non-hyperinflationary economy, the entity translates income and expenses using the exchange rate at the date of the transaction. Paragraph D13 of IFRS 1 already allows a first-time adopter to deem the cumulative translation differences for all foreign operations to be zero at its date of transition to IFRSs. We therefore conclude that no further exemption is needed in this respect.

Interaction with requirements on severe hyperinflation

26. We considered the interaction between the proposed amendment and the requirements in paragraphs D26–D30 of IFRS 1 for entities with a functional currency subject to severe hyperinflation. Paragraph D27 of IFRS 1 states:

> The currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics:
>
> (a) a reliable general price index is not available to all entities with transactions and balances in the currency.
>
> (b) exchangeability between the currency and a relatively stable foreign currency does not exist.

27. An entity is unable to comply with IAS 29 *Financial Reporting in Hyperinflationary Economy* if a reliable general price index is unavailable to all entities with that same functional currency. Paragraphs D29–D30 include requirements specifying how an entity can apply (or resume applying) IFRS Standards when its functional currency

ceases to be severely hyperinflationary. Applying these requirements, an entity may:

(a) elect to measure its assets and liabilities at fair value on the date of transition to IFRSs (paragraph D29 of IFRS 1); and

(b) present comparative information for a period of less than 12 months in particular circumstances if the functional currency normalisation date[1] falls within a 12-month comparative period (paragraph D30 of IFRS 1).

28. The proposed amendment would help entities estimate the spot exchange rate if the functional currency continues to lack exchangeability on or after the functional currency normalisation date. We think a specific exemption in relation to the proposed amendment is unnecessary in respect of entities applying paragraphs D26–D30 of IFRS 1.

29. We also note that paragraph D27(b) of IFRS 1 (see paragraph 26 above) refers to a lack of exchangeability but does not define it. We think there is benefit in aligning the wording in paragraph D27(b) with the definition of exchangeability in the proposed amendment and recommend doing so as a consequential amendment.

Staff recommendation

30. We recommend:

(a) providing no specific exemption for a first-time adopter in respect of the proposed amendment to IAS 21.

(b) aligning the wording in paragraph D27(b) of IFRS 1 with the definition and description of a lack of exchangeability in the proposed amendment.

Effective date and early application

31. We will discuss the effective date at the time of finalising the amendment, should the Board decide to proceed with it.

[1] The functional currency normalisation date is the date when the functional currency of an entity ceases to be subject to severe hyperinflation (paragraph D28 of IFRS 1).

32. We recommend permitting an entity to apply the amendment earlier than the effective date. As explained at previous meetings, estimating an exchange rate can be a complex process that requires the use of judgement. The review of a sample of financial statements shows that some entities already estimate an exchange rate when exchangeability is lacking. The amendment, if finalised, will improve consistency in the application of IAS 21 in these situations. We therefore see no reason to prohibit an entity from applying the proposed amendment earlier than the effective date.

Due process steps and permission for balloting

Comment period

33. Paragraph 6.7 of the *Due Process Handbook* states that the Board 'normally allows a minimum period of 120 days for comment on an Exposure Draft'. However, if the matter is narrow in scope and urgent, the Board may consider a shorter comment period.

34. The proposed amendment to IAS 21 is narrow in scope and, in our view, is not so urgent that it would warrant a comment period of less than 120 days. We therefore recommend a comment period of no less than 120 days for the Exposure Draft on the proposed amendment to IAS 21 (Exposure Draft).

Intention to dissent

35. In accordance with paragraph 6.9 of the *Due Process Handbook*, we are asking whether any Board member intends to dissent from the publication of the Exposure Draft.

Proposed timetable for balloting and publication

36. We plan to begin the balloting process in the near future and expect the Exposure Draft to be published in the fourth quarter of 2020.

Confirmation of the due process steps

37. Appendix A sets out the required due process steps in developing and publishing an Exposure Draft together with the current status of, and any planned action for, these steps. We note that the applicable due process steps to date for balloting of the Exposure Draft have been completed.

Questions for the Board

1. **Transition for entities already applying IFRS Standards—**does the Board agree with our recommendation in paragraph 22 of this paper?

2. Transition for first-time adopters—does the Board agree with our recommendation not to provide any specific exemption for first-time adopters in respect of the proposed amendment, and to consequentially amend paragraph D27(b) of IFRS 1 (see paragraph 30 of this paper)?

3. **Early application**—does the Board agree with our recommendation to permit an entity to apply the proposed amendment earlier than the effective date?

4. **Comment period**—does the Board agree with our recommendation to allow a comment period of no less than 120 days for the Exposure Draft?

5. **Dissent**—does any Board member intend to dissent from publication of the Exposure Draft?

6. **Permission to ballot**—is the Board satisfied that it has complied with the applicable due process steps and that it should begin the balloting process for the Exposure Draft?

Appendix A—Due process steps taken in developing the proposed amendment

A1. The following table summarises the required due process steps taken in developing the proposed amendment to IAS 21. The table does not list all of the optional steps.

Step	Actions
Board meetings are held in public, with papers available for observers. All decisions are made in public sessions	The Board discussed the matter at its meetings in November 2019 (see Agenda Paper 12, 12A, 12B, 12C and 12D), April 2020 (see Agenda Paper 12B, 12C, 12D and 12E) and July 2020 (see this Agenda Paper). The IFRS Interpretations Committee (Committee) discussed the matter at its meetings in June 2018 (see Agenda Paper 2), November 2018 (see Agenda Paper 8, 8A and 8B) and June 2019 (see Agenda Paper 14, 14A, 14B and 14C).
Consultation with the Trustees and the Advisory Council	The Trustees and Advisory Council will be updated on the project as part of their discussions of the Board's technical activities.
Analysis of likely effects of the forthcoming Standard or major amendment, for example, initial costs or ongoing associated costs	The proposed amendment is narrow in scope and would supplement but not change the underlying principles or requirements in IAS 21 for including foreign currency transactions and foreign operations in the financial statements of an entity. Consequently, we see no need to have a separate effects analysis. The main effect is expected to be more consistent application of the requirements in IAS 21 when a currency lacks exchangeability.
Outreach meetings with stakeholders	The Emerging Economies Group meeting discussed the matter at its meeting in March 2019 (see Agenda Paper 7, 7A, 7B and 7C). We also sought input from some investors (who had experience in analysing financial statements of entities with operations in jurisdictions whose functional currency lacks exchangeability) to help us better understand their information needs—see Agenda Paper 12E of the Board's April 2020 meeting.
Finalisation	
Due process steps reviewed by the IASB	This paper asks the Board to review the due process steps for the project.
The Exposure Draft has an appropriate comment period	This paper seeks the Board's approval for a comment period of no less than 120 days. The proposed comment period is in line with the minimum period specified in paragraph 6.7 of the IFRS Foundation *Due Process Handbook* and, therefore, no special approval is required from the Due Process Oversight Committee.

Drafting	
Drafting quality assurance steps are adequate	The translations, editorial and taxonomy teams will review drafts during the balloting process.
Publication	
Exposure Draft published	The Exposure Draft will be made available on the project website when published.
Press release to announce publication of the Exposure Draft	A press release will be published on our website with the Exposure Draft.

Appendix B—Excerpts from April 2020 IASB Update

B1. This appendix reproduces excerpts from the IASB Update April 2020 summarising the Board's tentative decisions with respect to the proposed amendment.

Lack of Exchangeability (Amendments to IAS 21)

The Board continued to discuss its proposed narrow-scope amendment to IAS 21 to address how an entity should determine the spot exchange to use when exchangeability between two currencies is lacking.

Exchangeability and lack of exchangeability

The Board tentatively decided that, when an entity assesses exchangeability, the entity be required to:

a. consider whether it could obtain the foreign currency within a time frame that includes a normal administrative delay.
b. consider its ability to obtain foreign currency, and not its intention (or decision) to do so.
c. consider only markets or exchange mechanisms that create enforceable rights and obligations.
d. assume that the purpose of obtaining foreign currency is to:
    i. settle individual foreign currency transactions, or assets or liabilities related to those transactions, when it reports foreign currency transactions in the functional currency; or
    ii. realise the entity's net assets when it uses a presentation currency other than the functional currency (or to realise its net investment in a foreign operation when it translates the results and financial position of that foreign operation).
e. conclude that a currency lacks exchangeability in circumstances in which it is able to obtain only some amounts of foreign currency, when, for a particular purpose, it is able to obtain no more than an insignificant amount of foreign currency. Additionally, when an entity (i) reports foreign currency transactions in its functional currency, and (ii) can obtain less than the amount of foreign currency it needs to settle all balances and transactions in that currency, the entity would be required to assess exchangeability on an aggregated basis for all the related foreign currency balances and transactions.

The exchange rate when a currency lacks exchangeability

The Board tentatively decided that:

a. an entity be required to estimate the spot rate when a currency lacks exchangeability.
b. the narrow-scope amendments set out an objective for the estimation process. The objective would require an entity to estimate a spot rate that:
    i. the entity would have been able to access at the reporting date had the currency been exchangeable;
    ii. would have arisen in an orderly transaction between market participants; and
    iii. would faithfully reflect the economic conditions prevailing at that date.

c. an entity be permitted to use an observable rate (that does not meet the definition of a spot rate) if that rate approximates the spot rate in the following circumstances:
    i. when the observable rate meets the definition of a spot rate for particular transactions or balances but not those for which the entity assesses exchangeability; or
    ii. when the observable rate is the first subsequent rate at which exchanges could be made if exchangeability is restored before financial statements are authorised for issue.

d. an entity be required to apply an estimated exchange rate to:
    i. the entire transaction or balance of an asset or liability (when the entity reports foreign currency transactions in the functional currency); or
    ii. the financial statements as a whole (when the entity uses a presentation currency other than the functional currency).

Disclosure requirements when a currency lacks exchangeability

The Board tentatively decided that an entity be required to disclose:

a. details of the currency that lacks exchangeability and a description of the restrictions that result in that lack of exchangeability;
b. a description of the transactions affected by the lack of exchangeability;
c. the carrying amount of assets and liabilities denominated in the currency that lacks exchangeability;
d. the spot rate(s) used and whether that rate is:
    i. an observable rate that approximates the spot rate, or
    ii. one that has been estimated;
e. a description of the estimation technique applied, and qualitative and quantitative information about the inputs used in that estimation technique; and
f. qualitative information about each type of risk to which the entity is exposed because of a currency's lack of exchangeability, and the nature and carrying amount of assets and liabilities exposed to each type of risk.

Additionally, the Board tentatively decided that, when a foreign operation's functional currency lacks exchangeability, an entity be required to disclose:

a. the name of the foreign operation, its nature (whether it is a subsidiary, joint operation, joint venture, associate or branch) and its principal place of business;
b. summarised financial information about the foreign operation; and
c. the nature and terms of any contractual arrangements that could require the entity to provide financial support to that foreign operation, including events or circumstances that could expose the reporting entity to a loss. The entity would also be required to disclose the balance of assets to which such arrangements give rise.