IFRS® Foundation

Lack of Exchangeability

Emerging Economies Group Meeting

Agenda Paper **2**
May 2022

Overview

- Purpose of this meeting
- Recap of the proposals
- Feedback and possible ways forward

Purpose of this meeting

Background	In April 2021 the IASB published the Exposure Draft *Lack of Exchangeability*, which proposed amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates*. At its January 2022 meeting the IASB discussed a summary of feedback on the Exposure Draft.
Purpose	The staff will ask EEG members to provide views on possible ways forward on: • Step I—assessing exchangeability between two currencies; and • Step II—determining the spot exchange rate when exchangeability is lacking. Questions for EEG members are on slides 14, 16, 18, 20, 22, 24 and 25.

Recap of the proposals

Why publish the Exposure Draft?

IAS 21 requirements

Use a spot exchange rate* to report foreign currency transactions, present financial statements in a different currency or translate a foreign operation

What if exchangeability between two currencies is lacking?

IAS 21 specifies the exchange rate to use when exchangeability between two currencies is temporarily lacking.

IAS 21 is silent when a lack of exchangeability is not temporary.

The Exposure Draft proposes to address *all* situations in which exchangeability between two currencies is lacking.

IASB's objectives

Improve usefulness

Reduce diversity

* Spot exchange rate is the exchange rate for immediate delivery

The proposed approach—at a glance

The IASB proposed a two-step approach

Step I	Assess exchangeability between two currencies

If the currency is not exchangeable into the other currency

Step II	Determine the spot exchange rate when exchangeability is lacking

Step I: Assessing exchangeability between two currencies

A currency is exchangeable into another currency when an entity is able to exchange that currency for the other currency

An entity considers	Time frame to obtain the other currency	Ability to obtain the other currency	Markets or exchange mechanisms that result in enforceable rights and obligations

Purpose	Reporting foreign currency transactions	Settle individual transactions, assets or liabilities	Translate foreign operation/ different presentation currency	Realise net investment in foreign operation/ net assets

A currency is not exchangeable into the other currency if the entity is able to obtain **no more than an insignificant amount** of the other currency for the identified reporting purpose

Step II: Determining the spot exchange rate (1/2)

Estimate the spot exchange rate at the measurement date

Conditions the estimated rate would be required to meet (assessed at the measurement date)

- would have applied to an exchange transaction
- would have applied to an orderly transaction between market participants
- faithfully reflects prevailing economic conditions

Step II: Determining the spot exchange rate (2/2)

How to determine the spot exchange rate

Permitted to use a spot exchange rate for another purpose if the rate meets the conditions of the estimated rate

Permitted to use the first exchange rate after exchangeability is restored if the rate meets the conditions of the estimated rate

Use an estimation technique

Disclosure when a currency is not exchangeable

Objective: disclose information that enables investors to understand the effect of the lack of exchangeability on an entity's financial performance, financial position and cash flows

An entity would be required to disclose

Details of the currency and a description of the restrictions	Description of affected transactions	Carrying amount of affected assets and liabilities
The spot rate used	Description of any estimation technique used, and qualitative and quantitative information about the inputs used	Information about risks to which the entity is exposed because of the currency's lack of exchangeability

Additional disclosures would apply when a foreign operation's functional currency lacks exchangeability

Feedback and possible ways forward

Topics

Step I:	Holistic consideration of factors
	Level of assessment
Steps I and II:	Use of unofficial rates
Step II:	Estimated rate (19A conditions)
	Observable rates (19B)
	Reference rates
	Examples / application guidance

Step I: Holistic consideration of factors

Proposed requirements

Proposed paragraphs A2–A4 state [emphasis added]:

A2. A currency is exchangeable into another currency at a measurement date when an entity is able to exchange that currency for the other currency within a time frame that includes a normal administrative delay and through a market or exchange mechanism in which the exchange transaction would create enforceable rights and obligations. If an entity is able to obtain no more than an insignificant amount of the other currency, a currency is not exchangeable into the other currency.

A3. An entity shall assess whether a currency is exchangeable into the other currency separately for each reporting purpose specified in paragraph A9.

A4. The requirements in paragraphs A5–A11 specify how an entity assesses whether a currency is exchangeable into another currency.

Step I: Holistic consideration of factors

Feedback

Feedback indicates that some respondents read the proposed required factors to be considered in assessing exchangeability as applying individually or separately, instead of holistically. If applied individually or separately, questions then arise about the interaction between the factors.

Possible ways forward

Emphasise and clarify the requirements in proposed paragraphs A2–A4—that an entity needs to consider holistically all factors in assessing exchangeability.

Do you think this will address the feedback? Do you have any other comments or suggestions?

Step I: Level of assessment

Existing requirements

The Exposure Draft does not propose to change IAS 21's level of assessment and application (which is at an entity level).

Paragraph 3 of IAS 21 states that the Standard shall be applied:

(a) in accounting for transactions and balances in foreign currencies…;

(b) in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation or the equity method; and

(c) in translating an entity's results and financial position into a presentation currency.

Step I: Level of assessment

Feedback

Paragraph 4 of IAS 29 *Financial Reporting in Hyperinflationary Economies* states ‘it is preferable that all entities that report in the currency of the same hyperinflationary economy apply this Standard from the same date’.

A few respondents suggested exchangeability be assessed at a jurisdiction level, rather than at an entity level—similar to assessing hyperinflation in IAS 29.

Possible ways forward

Reaffirm assessment at an entity level—although entities might often be in the same position regarding the exchangeability of one currency into another, some entities may be able to obtain the other currency for an identified purpose whilst others are not.

Do you think exchangeability should be assessed at a jurisdiction level rather than at an entity level?

If yes, how would entities (practically) assess exchangeability at a jurisdiction level?

Steps I and II: Use of unofficial rates

Proposed requirements

Proposed paragraph A7 states [emphasis added]:

In assessing whether a currency is exchangeable into another currency, an entity shall consider only markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations. Enforceability is a matter of law. Whether an exchange transaction in a market or exchange mechanism would create enforceable rights and obligations depends on facts and circumstances.

Proposed paragraphs 19A–19B are silent on the use of unofficial (or ‘parallel’ or ‘black market’) rates in determining the spot exchange rate when exchangeability is lacking.

Steps I and II: Use of unofficial rates

Feedback

Clarify that an entity cannot consider unofficial (or ‘parallel’ or ‘black market’) rates in assessing exchangeability between two currencies (Step I) but, when exchangeability is lacking, those rates can be used to estimate the spot exchange rate (Step II).

Possible ways forward

Clarify that those rates cannot be used in Step I but can be used as a starting point for estimating the spot exchange rate in Step II.

Do you think this will address the feedback? Do you have any other comments or suggestions?

Step II: Estimated rate (19A conditions)

Proposed requirements

Proposed paragraph 19A states [emphasis added]:

When exchangeability between two currencies is lacking—that is, when a currency is not exchangeable into another currency (as described in paragraphs A2–A11) at a measurement date—an entity **shall estimate** the spot exchange rate at that date. The estimated spot exchange rate **shall meet** the following conditions assessed at the measurement date:

(a) a rate at which an entity would have been able to enter into an exchange transaction had the currency been exchangeable into the other currency;

(b) a rate that would have applied to an orderly transaction between market participants; and

(c) a rate that faithfully reflects the prevailing economic conditions.

Step II: Estimated rate (19A conditions)

Feedback

- when exchangeability is lacking, meeting the conditions in proposed paragraph 19A may be impracticable.
- it is questionable whether exchangeability would actually be lacking if the conditions were met.
- revise the proposal to specify that the conditions are objectives an entity aims to meet when estimating the spot exchange rate, rather than requirements to be met.

Possible ways forward

Amend proposed paragraph 19A to require an entity to best reflect, rather than meet, all the conditions in paragraphs 19A(a)–19A(c).

Do you think this will address the feedback? Do you have any other comments or suggestions?

Step II: Observable rates (19B)

Proposed requirements

Proposed paragraph 19B states [emphasis added]:

In estimating the spot exchange rate as required by paragraph 19A, an entity **may use** an observable exchange rate as the estimated spot exchange rate when that observable exchange rate meets the conditions in paragraph 19A and is either:

(a) a spot exchange rate for a purpose other than that for which the entity assesses exchangeability; or

(b) the first exchange rate at which an entity is able to obtain the other currency after exchangeability of the currency is restored (first subsequent exchange rate).

Step II: Observable rates (19B)

Feedback

- wording in proposed paragraph 19B is unclear.
- maximise the use of observable exchange rates, similar to the fair value hierarchy in IFRS 13 *Fair Value Measurement.*
- specify a required sequencing of using observable exchange rates, with differing views as to what the sequence should be.

Possible ways forward

Continue to permit, but not require, the use of observable rates and further explain in the Basis for Conclusions why we are doing so.

Do you agree? Do you have any other comments or suggestions?

Step II: Reference rates and examples / application guidance

Basis for Conclusions

Paragraph BC18 of the Exposure Draft states [emphasis added]:

…The [IASB] did not propose any detailed requirements on how an entity should make that estimation because:

(a) estimating a spot exchange rate can be complicated and would depend on entity-specific and jurisdiction-specific facts and circumstances.

(b) there are many economic models an entity might use to estimate a spot exchange rate… Prescribing one estimation technique or approach would be inappropriate because it would be unlikely to capture all relevant factors for all possible situations in a way that would not be too burdensome.

(c) the requirements for assessing exchangeability are expected to result in an entity estimating the spot exchange rate only in a narrow set of circumstances.

(d) the uncertainties inherent in estimating a spot exchange rate are similar to those that relate to other financial information based on estimates. Disclosing relevant information about the estimated spot exchange rate and the estimation technique would supplement the proposed approach…

(e) such an approach is consistent with the measurement requirements in other IFRS [Accounting] Standards…

Step II: Reference rates

Feedback

- permit or illustrate use of particular references (for example, inputs or mechanisms) in estimating the spot exchange rate.
- require an entity to maximise the use of observable inputs.
- clarify whether implied rates or rates from indirect currency exchange mechanisms are observable exchange rates.

Possible ways forward

Reaffirm reasons in the Basis for Conclusions for not providing application guidance on estimation techniques or approaches.

However, should particular reference rates be specifically permitted? Should an entity be required to maximise the use of observable inputs?

Do you have any other comments or suggestions?

Step II: Examples / application guidance

Feedback

- provide examples or application guidance to support application of paragraphs 19A and 19B.
- provide examples or application guidance on estimating a spot exchange rate (for example, techniques and inputs).

Possible ways forward

Reaffirm reasons for not providing more application guidance on estimation techniques or approaches.

Recommend not adding examples—other changes will make it easier for entities to estimate a spot exchange rate.

Do you agree? Do you have any other comments or suggestions?

Find us online

ifrs.org

@IFRSFoundation

IFRS Foundation

IFRS Foundation

International Accounting Standards Board

International Sustainability Standards Board