STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Lack of exchangeability (IAS 21)**		
Paper topic	The exchange rate when exchangeability is lacking		
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Purpose

1. Agenda Paper 14A for this meeting presents our analysis and recommendations on how to define a currency's exchangeability and, thus, lack of exchangeability. This paper presents our analysis and recommendations on the spot exchange rate (spot rate) an entity uses when exchangeability of a currency is lacking.

Structure of the paper

2. This paper includes:
   (a) Committee feedback and main changes from the staff preliminary views (paragraphs 4–13); and
   (b) our analysis and recommendations (paragraphs 14–54).
3. This paper also includes four appendices:
   (a) Appendix A—flowchart summarising the staff recommendations.
   (b) Appendix B—other considerations relating to how an entity estimates a spot rate.

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(c) Appendix C—analysis of Committee feedback on the preliminary definitions of temporary and long-term lack of exchangeability.

(d) Appendix D—analysis of Committee feedback on the estimation of a spot rate.

Committee feedback and main changes from the staff preliminary views

4. Agenda Papers 8A and 8B for the Committee's November 2018 meeting (hereafter, the November agenda papers) presented our preliminary views on:

   (a) the definition of temporary and long-term lack of exchangeability; and

   (b) determining the spot rate when a currency is not exchangeable.

5. Our analysis and recommendations in this paper incorporate Committee feedback on our preliminary views. This section of the paper presents an overview of that feedback and discusses the main changes we made to our preliminary views in the light of that feedback. Appendices C and D to this paper present a more detailed overview and analysis of Committee feedback on our preliminary views.

Staff preliminary views

6. Our preliminary views set out in the November agenda papers were that:

   (a) a temporary lack of exchangeability would be a situation in which:

      (i) a currency is not exchangeable at the end of the reporting period (reporting date)[1]; but

      (ii) the exchangeability of the currency is restored after the reporting date and before the date on which the financial statements are authorised for issue.

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[1] Or at the date of the transaction as applicable. For ease of reference, we use 'reporting date' throughout this paper.

(b) a long-term lack of exchangeability would be a lack of exchangeability that is other than temporary.

7. We also explained that if a currency were subject to:

   (a) a temporary lack of exchangeability, an entity would use the first subsequent exchange rate at which exchanges could be made (as currently specified in paragraph 26 of IAS 21 for foreign currency transactions reported in the functional currency).

   (b) a long-term lack of exchangeability, an entity would then estimate a spot rate.

8. The proposals in paragraph 7 above would have applied, regardless of whether the entity reports foreign currency transactions in the functional currency or uses a presentation currency other than the functional currency.

Overview of Committee feedback

9. Committee members generally agreed with the proposed requirements that would apply when a currency is subject to a long-term lack of exchangeability (ie using an estimated spot rate). However, some Committee members expressed concerns about the proposed definition of temporary lack of exchangeability and the proposed requirements that would apply in that situation.

10. Those Committee members said the first subsequent rate at which exchanges could be made may not always reflect the conditions existing at the reporting date, in particular if (a) a long period of time has elapsed between the end of the reporting period and the date when the financial statements are authorised for issue, or (b) if the currency is hyperinflationary. Accordingly, the first subsequent rate may not always be the most appropriate rate to use when a currency is subject to a temporary lack of exchangeability. Requiring entities to use this rate could also result in differences between entities solely because of differing dates of authorising financial statements for issue—accordingly, this could affect comparability between entities.

Changes to our preliminary views

11. Based on our analysis in this paper (see paragraphs C7–C19 of Appendix C) and in the light of Committee feedback, we think it is not necessary to define temporary and long-term lack of exchangeability. Rather, any requirements that would apply when a currency is not exchangeable (whether temporary or long-term) would build on the requirement in IAS 21 to use a spot rate at the reporting date.

12. When a currency is not exchangeable, we think an entity should use a spot rate that reflects conditions existing at the reporting date. Because this rate is not observable at the reporting date, we think an entity should estimate that rate. Any estimation technique should meet the estimation objective set out in paragraph 15 of this paper.

13. However, in situations in which exchangeability has been restored before the financial statements are authorised for issue, rather than using an estimation technique an entity could use the first subsequent rate at which transactions could be made if this rate would approximate the spot rate at the reporting date.

Staff analysis and recommendations

Proposed approach

14. As discussed in paragraph 12 of Agenda Paper 14, we have not reconsidered the requirement in IAS 21 to use a spot rate. Rather, the approach we propose in this paper builds on that requirement. Paragraph 8 of IAS 21 defines a spot rate as 'the exchange rate for immediate delivery'. Applying our proposed definition (as set out in Agenda Paper 14A for this meeting), exchangeability is lacking when an entity would be unable to exchange a currency for another currency at a specified date. Accordingly, a lack of exchangeability results in an entity being unable to observe a spot rate at the reporting date.

15. We think when a currency is not exchangeable, an entity should estimate a spot rate. In our view, the objective should be to estimate a spot rate that would:

    (a) be the rate that:

        (a) an entity would have been able to access at the reporting date had exchangeability (as defined in Agenda Paper 14A) not been lacking; and

        (b) would have arisen in an orderly transaction between market participants at the reporting date.

    (b) faithfully reflects the economic conditions prevailing at the reporting date.

16. In our view, this approach together with relevant disclosure (discussed in Agenda Paper 14C for this meeting) would faithfully represent the amounts at which assets and liabilities could have been realised (settled) at the reporting date had the currency been exchangeable.

17. Nonetheless, a lack of exchangeability would not automatically mean that an entity would be required to use an estimation technique to determine the spot rate. We think there are circumstances in which an entity might use an observable rate (that is not a spot rate) as a proxy for the estimated spot rate. This would be the case when the observable rate meets the objective specified above in paragraph 15. In our view, this could occur when:

    (a) a rate is observable at the reporting date but applies only to transactions or balances other than the transaction or balance for which the entity assesses exchangeability (see paragraphs 31–38 of this paper);

    (b) exchangeability is restored after the end of the reporting period but before financial statements are authorised for issue. In this situation, a rate is observable at a date after the reporting date (see paragraphs 39–44 of this paper).

Staff recommendations

18. We recommend that any amendment require an entity to estimate the spot rate when exchangeability of a currency is lacking. An entity would use that estimated spot rate both when:

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

    (b) uses a presentation currency other than the functional currency.

19. In such circumstances, we further recommend that any amendment set out an objective for the related estimation process. The objective would require an entity to estimate a rate that would:

    (a) be the rate that:

        (a) an entity would have been able to access at the reporting date had exchangeability (as defined in Agenda Paper 14A) not been lacking; and

        (b) would have arisen in an orderly transaction between market participants at the reporting date.

    (b) faithfully reflects the economic conditions prevailing at the reporting date.

Applying the proposed approach

Estimating the spot rate

20. We are aware that there are many economic models (with varying degrees of complexity) that an entity might use to estimate a spot rate. Those models (or techniques) use one or several of the following economic factors as inputs:

    (a) inflation (or the level of prices);

    (b) interest rates;

    (c) the balance of payments—the jurisdictional money supply and demand;

    (d) a jurisdiction's productivity; and/or

    (e) other factors.

21. For example, the November agenda papers presented an economic theory, the Purchasing Power Parity Theory, that highlights inflation as one of the key determinants of exchange rates. Those papers also explained how some entities use this theory to estimate an exchange rate.

22. We acknowledge that estimating a spot rate could be a complex process that may require the use of judgement.

23. In our view, any amendment should narrow the circumstances in which an entity would be required to use an estimated spot rate. This would mitigate concerns about estimation complexities. We think there are two ways of narrowing those circumstances:

    (a) defining narrowly a lack of exchangeability. We think our recommendations in Agenda Paper 14A for this meeting meet this objective.

    (b) permitting the use of an observable rate that does not meet the definition of a spot rate if that rate would approximate the spot rate that would have been observed at the reporting date had the currency been exchangeable. We discuss this point further in paragraphs 30–44 of this paper.

24. We also think, in estimating the spot rate, an entity would not necessarily need to use a complex estimation technique (that would involve consideration of all possible economic factors). In some situations, an entity could estimate the spot rate by starting with either (a) an observable rate that does not meet the definition of a spot rate[2], or (ii) a spot rate at a date other than the reporting date. The entity would then adjust that observable rate, as needed, to estimate the spot rate at the reporting date.

25. Furthermore, consistent with our preliminary views in November, we think any amendment should not specify detailed requirements on how to estimate a spot rate, nor prescribe a particular technique for it. We also think any amendment should not provide a hierarchy of inputs an entity would consider when applying an estimation

[2] For example, an official exchange rate that the entity cannot access.

technique. Many estimation techniques use one or a limited number of inputs. Those techniques also use different inputs. Our recommendation regarding defining exchangeability is to be prescriptive in setting the parameters for when an entity would estimate the spot rate, and to set those parameters so that they would be met only in a narrow set of circumstances. Because of that, it would be unnecessary to be more prescriptive than suggested regarding how to estimate the spot rate.

26. Some might say not including detailed requirements, or prescribing a technique, could lead to entities applying different techniques and, thus, a lack of comparability between entities. However, we recommend retaining a principle-based approach on the grounds that:

    (a) this approach is consistent with the overall approach in IFRS Standards, and with the measurement requirements in particular Standards. For example, IFRS 9 *Financial Instruments* does not specify any particular technique for the measurement of expected credit losses, but instead sets out a clear objective;

    (b) the matter of estimating an exchange rate is debated among economists. We understand there is no consensus on which technique might provide the best outcome;

    (c) the selection of an appropriate estimation technique may require the use of judgement, considering entity and jurisdiction-specific facts and circumstances;

    (d) estimation models have varying degrees of complexity; and

    (e) identifying an appropriate estimation technique could result in (i) extensive standard-setting work, and (ii) not capturing all relevant factors for all possible situations.

27. Some might also say the complexity involved in estimating a spot rate, together with no prescribed estimation technique, could result in significant uncertainties about the rate estimated. Those uncertainties could undermine the principle of faithful representation. We think the uncertainties inherent in estimating a spot rate are not

different from those that relate to other information based on estimates. The use of estimates is embedded in preparing IFRS-compliant financial statements.

28. We note that paragraph 2.18 of the 2018 *Conceptual Framework* states:

> Faithful representation does not mean accurate in all respects... For example, an estimate of an unobservable price or value cannot be determined to be accurate or inaccurate. However, a representation of that estimate can be faithful if the amount is described clearly and accurately as being an estimate, the nature and limitations of the estimating process are explained, and no errors have been made in selecting and applying an appropriate process for developing the estimate.

29. Agenda Paper 14C for this meeting discusses disclosures that an entity would provide when estimating a spot rate. We think these disclosures would help alleviate any concerns regarding faithful representation.

Using an observable rate as an approximation for the spot rate

30. We think, in some situations, without having to make any adjustments an entity might be able to use an observable rate that would:

    (a) not meet the definition a spot rate for a specified transaction; but

    (b) would meet the objective of estimating a spot rate (see paragraph 15 of this paper).

Using an observable rate at the reporting date

31. In Agenda Paper 14A for this meeting, we recommend that the definition of exchangeability includes consideration of the purpose for which an entity obtains foreign currency. Accordingly, a currency may not be exchangeable for a particular purpose but may be exchangeable for other purposes.

32. We think, in some situations, an entity might be able to conclude that the observable rate for other transactions or balances for which the currency is exchangeable approximates the spot rate for the transaction or balance for which exchangeability is

lacking. Therefore, an entity could use the observable rate for those other transactions at the reporting date, without needing to use an estimation technique.

33. For example, assume an entity has a foreign operation in a jurisdiction whose currency is free-floating with limited intervention by the jurisdictional authorities. There is one exchange rate that applies to all exchange transactions and this rate faithfully reflects economic conditions prevailing at the reporting date. Nonetheless, to avoid capital outflows jurisdictional authorities do not allow entities to obtain foreign currency for a purpose that would result in the entity recovering its net investment in the foreign operation (for example, dividend-remittances).

34. In this example, we think the facts and circumstances indicate that the observable rate applying to transactions for which the currency is exchangeable could approximate the spot rate for other transactions, such as paying dividends. This is because the facts and circumstances indicate that this rate would have applied at the reporting date (ie there is only one exchange rate for the currency and that rate faithfully reflects economic conditions prevailing at the reporting date).

35. In our view, an entity could consider the following non-exhaustive list of indicators when assessing whether an observable rate would approximate the spot rate:

   (a) *the nature of the exchange rate structure*—ie whether several exchange rates exist for the currency. The existence of more than one exchange rate indicates that the monetary or jurisdictional authorities set exchange rates to encourage, or deter, entities from entering into particular transactions. Accordingly, the differing observable rates may include a 'penalty' or 'incentive' and may not faithfully reflect all relevant economic conditions.

   (b) *the number and type of transactions for which the currency is exchangeable*—if an entity could obtain foreign currency for only particular types of transactions (such as emergency supplies), the exchange rate observed may not faithfully reflect all relevant economic conditions.

   (c) *the nature of the exchange rate arrangement*—a free-floating exchange rate observable on a market would more faithfully reflect economic conditions

than an exchange rate set through regular interventions from the monetary or jurisdictional authorities.

(d) *the frequency at which exchange rates are updated*—an exchange rate that is unchanged over a long period of time is less likely to faithfully reflect economic conditions than a rate that is updated every day, or several times per day.

36. We think there is benefit in:

(a) explicitly permitting an entity to use an observable rate that does not meet the definition of a spot rate if that observable rate would approximate the spot rate, and

(b) listing the indicators in paragraph 35 of this paper as application guidance to help entities assess whether the observable rate would approximate the spot rate at the reporting date.

37. We think doing so would also address some Committee members' concerns about our proposed definitions of exchangeability and a lack thereof (see paragraphs 58–60 of Agenda Paper 14A for this meeting). Those Committee members said entities might experience long delays when realising their net investment in some foreign operations (such as through the remittance of dividends). In such circumstances, entities may conclude that the functional currency of a foreign operation is not exchangeable for transactions that would result in realising the entity's net investment in the foreign operation. However, in many of those jurisdictions the local currency may be exchangeable for other purposes. Applying the proposed approach in paragraph 36 of this paper, we think an entity might often be able to use an observable rate as an approximation for the spot rate at the reporting date.

38. We considered whether an entity should be permitted or required to use the observable rate as described in paragraph 32 of this paper (when that rate approximates the spot rate). We think the use of such an observable rate should be permitted. Requiring the use of an observable rate could, in some situations, be unduly onerous and add unnecessary complexity when implementing any amendment. If the use of such an observable rate were required, an entity would have to (i) first

identify all observable rates, (ii) assess which of those rates approximates the spot rate, and (iii) estimate the spot rate only if step (ii) is inconclusive.

Using the first subsequent rate at which exchanges could be made

39. Paragraph 26 of IAS 21 requires an entity that reports foreign currency transactions in a functional currency to use the first subsequent rate at which exchanges could be made if exchangeability is temporarily lacking. IAS 21 neither defines 'temporarily' nor contains requirements for any other situation in which exchangeability is lacking (ie when an entity uses a presentation currency other than the functional currency or when a lack of exchangeability is other than temporary).

40. As explained in paragraph C17(a) of Appendix C, requiring the use of an estimated exchange rate for all circumstances in which exchangeability is lacking would result in amending the requirements in paragraph 26 of IAS 21.

41. Nonetheless, we think there are circumstances in which an entity might conclude that the first subsequent rate at which transactions could be made approximates the spot rate for the transaction or balance for which exchangeability is lacking. Accordingly, an entity could use this rate as the spot rate at the reporting date.

42. We think an entity could consider the following non-exhaustive list of indicators `when assessing whether the first subsequent observable rate would approximate the spot rate:

    (a) *the time period between the reporting date and the date at which exchangeability is restored*— the likelihood that the first subsequent rate would approximate the spot rate at the reporting date would reduce as the time period that elapses increases. This is because economic conditions could change significantly over a long period.

    (b) *whether the currency is the one of a hyperinflationary or highly-inflationary economy*—inflation is a key determinant of the exchange rate. In general, the exchange rate decreases in a manner commensurate with inflation. When a currency is hyperinflationary (or highly-inflationary), prices change quickly and might even change several times per day.

Accordingly, the first subsequent rate for a hyperinflationary currency is unlikely to approximate the spot rate at the reporting date.

43. We think there is benefit in:

    (a) explicitly permitting an entity to use the first subsequent rate for the purpose of a specified transaction if that rate would approximate the spot rate; and

    (b) listing the indicators in paragraph 42 of this paper as application guidance to help entities assess whether that rate would approximate the spot rate at the reporting date.

44. We considered whether an entity should be permitted or required to use the observable rate as described in paragraph 41 of this paper (when that rate approximates the spot rate). We think the use of such an observable rate should be permitted. Requiring the use of such an observable rate could, in some situations, be unduly onerous and add unnecessary complexity when implementing any amendment. If the use of such an observable rate were required, any entity would have to (i) first identify the first subsequent rate at which exchanges could be made, (ii) assess whether this rate approximates the spot rate, and (iii) estimate the spot rate only if step (ii) is inconclusive.

Staff recommendations

45. We recommend any amendment neither specifies how an entity estimates the spot rate at the reporting date nor prescribes a particular estimation technique.

46. We also recommend that an entity be permitted to use an observable rate that does not meet the definition of a spot rate for the purpose of a specified transaction if that rate approximates the spot rate at the reporting date. An entity would be able to use such an observable rate:

    (a) that meets the definition of a spot rate for particular transactions or balances but not those for which the entity assesses exchangeability; or

(b) that is the first subsequent rate at which exchanges could be made if exchangeability is restored before financial statements are authorised for issue.

Ability to convert only some amounts of foreign currency

Analysis

47. As discussed in Agenda Paper 14A for this meeting, we recommend specifying that exchangeability is lacking when an entity would be unable to exchange more than an insignificant amount of foreign currency. Because there could be an observable spot rate for some portion of a foreign currency transaction, we considered whether an entity should be required to use:

    (a) a blended rate ('blended approach') that would reflect both:

        (i) the rate the entity could obtain for the exchangeable portion of the transaction, and

        (ii) an estimated rate for the remaining portion; or

    (b) an estimated rate for the entire transaction ('estimated approach').

48. The use of the blended approach would, in our view, faithfully depict a foreign currency transaction or balance. Nonetheless, we recommend the estimated approach. This is because:

    (a) applying the blended approach could be practically challenging, thereby increasing costs for preparers without providing significant additional benefits.

    (b) an entity would be able to exchange only an insignificant amount of foreign currency[3]. Accordingly, applying the blended approach an entity would use the observable spot rate only for an insignificant portion of the transaction or balance (and the estimated rate for the remaining portion). In most cases,

[3] This is based on our recommendation that exchangeability is lacking when an entity cannot exchange more than an insignificant amount of foreign currency.

we would expect the outcome not to differ significantly from the estimated approach.

49. We considered whether to recommend giving entities the option of applying either the estimated approach or the blended approach, but decided not to do so. We think this situation would arise infrequently (ie only when an entity is able to exchange some, but less than an insignificant, amount of foreign currency) and allowing an option would reduce comparability. We also think there might be situations in which the observable rate (that applies to the exchangeable portion of the transaction) approximates the spot rate for the entire transaction. Accordingly, an entity might be able to use the observable rate with no adjustments, which would result in no difference between the two approaches.

Staff recommendation

50. When exchangeability is lacking, we recommend that the entity apply an estimated exchange rate to (a) the entire transaction or balance of an asset or liability (when the entity reports foreign currency transactions in the functional currency), or (b) the financial statements as a whole (when an entity uses a presentation currency other than the functional currency).

Other matters

51. Appendix B to this paper analyses two matters relating to estimating the spot rate. In particular, it discusses situations in which:

    (a) the functional currency is that of a hyperinflationary economy; and

    (b) a currency is only indirectly exchangeable into another currency.

52. Based on our analysis in Appendix B, we recommend no specific requirements in respect of these matters.

Staff recommendations

53. We recommend that:

    (a) any amendment require an entity to estimate the spot rate when exchangeability of a currency is lacking. An entity would use that estimated rate both when:

        (i) it reports foreign currency transactions in its functional currency; and

        (ii) uses a presentation currency other than the functional currency.

    (b) any amendment set out an objective for the related estimation process and not specify how an entity estimates the spot rate at the reporting date nor prescribe a particular estimation technique. The objective would require an entity to estimate a rate that would:

        (i) be the rate that:

            1. an entity would have been able to access at the reporting date had exchangeability (as defined in Agenda Paper 14A) not been lacking; and

            2. would have arisen in an orderly transaction between market participants at the reporting date.

        (ii) faithfully reflects the economic conditions prevailing at the reporting date.

    (c) an entity be permitted to use an observable rate that does not meet the definition of a spot rate for the purpose of a specified transaction if that rate approximates the spot rate at the reporting date. An entity would be able to use such an observable rate:

        (i) that meets the definition of a spot exchange rate for particular transactions or balances but not those for which the entity assesses exchangeability; or

        (ii) that 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 apply an estimated exchange rate to:

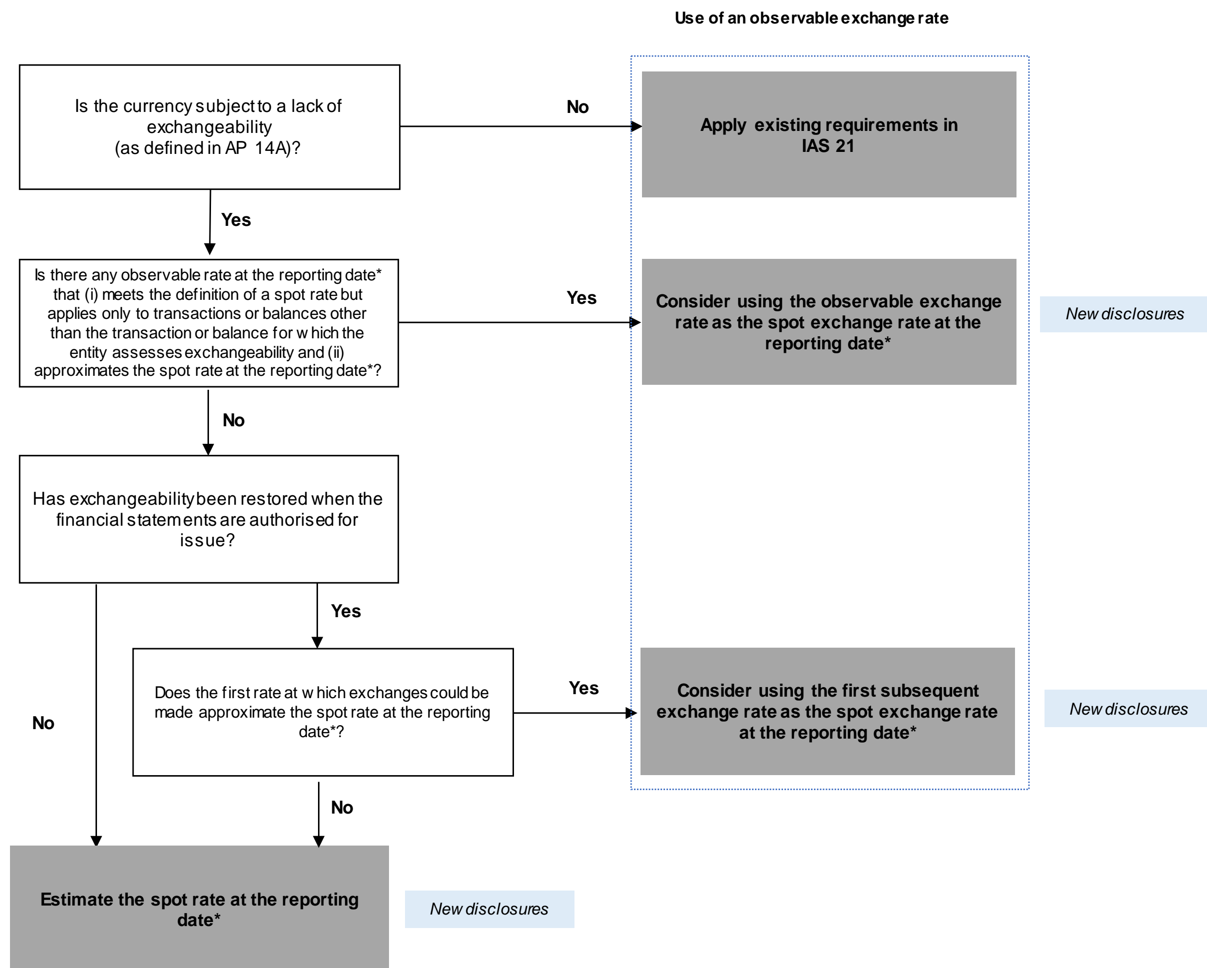
  (i) the entire transaction or balance of an asset or liability (when the entity reports foreign currency transactions in the functional currency), or

  (ii) the financial statements as a whole (when an entity uses a presentation currency other than the functional currency)

54. For ease of reference, the flowchart in Appendix A to this paper provides a summary of our recommendations.

Question for the Committee
Does the Committee agree with our recommendations set out in paragraph 53 of this paper? Does the Committee have any other suggestions?

Appendix A—flowchart summarising the staff recommendations



Appendix B—other considerations relating to how an entity estimates a spot rate

B1. This appendix considers two matters relating to how an entity estimates a spot rate.

Functional currency is that of a hyperinflationary economy

B2. An entity whose functional currency is that of a hyperinflationary economy applies IAS 29 *Financial Reporting in Hyperinflationary Economies*. IAS 29 specifies requirements that result in restating such an entity's financial statements in terms of the measuring unit current at the reporting date. As a consequence, the entity's financial statements reflect the effect of changing prices (in other words, inflation). Because of this, some say if an entity translates those financial statements into a presentation currency, the exchange rate used for translation should reflect only inflation—ie the entity should apply a rate estimated using a model with only inflation as an input.

B3. We recommend no specific requirements when exchangeability is lacking for a currency of a hyperinflationary economy. By requiring entities to faithfully reflect prevailing economic conditions and not prescribing how an entity estimates a spot rate, an entity would apply judgement in estimating the spot rate in those situations. We would generally expect inflation to be an important consideration in those circumstances.

Indirect exchange mechanism

B4. We considered a situation in which an entity might not be able to directly exchange a local currency (X) for a particular foreign currency (Y). However, it might be able to:

(a) exchange the local currency (X) for another foreign currency (Z); and

(b) exchange that other foreign currency (Z) for the required foreign currency (Y) through a legally accessible market or jurisdiction.

B5. In this situation, we think the local currency (X) is exchangeable because the entity is able to exchange (indirectly) the local currency (X) for the foreign currency (Y). In this case, an entity would derive the applicable exchange rate by using the spot rates between (a) currencies X and Y, and (b) currencies Y and Z. We recommend no specific requirements in this respect.

Appendix C—analysis of Committee feedback on the preliminary definitions of temporary and long-term lack of exchangeability

Staff preliminary views

C1. Paragraphs 6–8 of this paper discuss our preliminary views on the definitions of temporary and long-term lack of exchangeability.

Committee feedback

C2. Committee members had mixed views on those preliminary definitions.

C3. One Committee member disagreed with the preliminary definition of temporary lack of exchangeability. This Committee member said:

- (a) the requirement in paragraph 26 of IAS 21 to use the first subsequent rate at which exchanges could be made applies only when that first subsequent rate reflects the rate that would have been observed at the reporting date had the currency been exchangeable. Accordingly, a long-term lack of exchangeability could exist even if exchangeability is restored before the date on which financial statements are authorised for issue.
- (b) using the first subsequent rate may not reflect the exchange rate that would have been observed at the reporting date when:
  - (i) exchangeability has been lacking for many years; and
  - (ii) the currency subject to a lack of exchangeability is hyperinflationary.

C4. Similarly, another Committee member said using the first subsequent rate that is observed several months (or years) after the reporting date may not result in useful information because that rate may not reflect the circumstances existing at the reporting date.

C5. Two Committee members said the preliminary definitions could result in a lack of comparability between entities solely because of different dates of authorising financial statements for issue. For example, if exchangeability is lacking at the

reporting date and is restored only some months later, an entity that issues financial statements before exchangeability is restored would estimate the spot rate while an entity that issues its financial statements after exchangeability is restored would use the first subsequent rate at which exchanges could be made.

C6. One Committee member asked whether the proposed requirements would be consistent with paragraph 28 of IAS 34 *Interim Financial Reporting*, which states that '…the frequency of an entity's reporting (annual, half-yearly, or quarterly) shall not affect the measurement of its annual results...'.

Staff analysis and response

Analysis

C7. IAS 21 does not explain the basis for the requirement in paragraph 26 to use the first subsequent rate at which exchanges could be made when exchangeability is temporarily lacking. In particular, it is not clear whether the requirement reflects the view that:

- (a) the first subsequent rate would generally reflect conditions existing at the reporting date;
- (b) exchangeability being restored is an adjusting event after the reporting period (as defined in IAS 10 *Events after the Reporting Period*); or
- (c) the use of an observable rate would provide more useful information than an estimated rate (the first subsequent rate would be observable while an estimated rate would not).

C8. Some Committee members' feedback indicates support for the use of the first subsequent rate only when that rate would reflect conditions existing at the reporting date—ie a rate that approximates the spot rate that would have been observed at the reporting date had the currency been exchangeable.

C9. We agree that our preliminary views could result in the use of a rate that might not reflect conditions existing at the reporting date, and thus may not always provide the most useful information—this is because an entity would always use that first

subsequent rate if exchangeability is restored, without assessing whether the rate reflects conditions existing at the reporting date.

Approaches considered

C10. In the light of this feedback, we considered two possible approaches:

(a) *Approach A*—Retain (i) the definitions of temporary and long-term lack of exchangeability and (ii) the requirements applying in such circumstances, as presented in the November agenda papers (see paragraphs 6–8 of this paper).

(b) *Approach B*—Remove any reference in IAS 21 to temporary or long-term lack of exchangeability and, instead, require the use of a spot rate that reflects conditions existing at the reporting date.

Assessment of *Approach A*

C11. As explained in the November agenda papers, we think *Approach A* would:

(a) not require the use of extensive judgement—this is because the proposed definitions would set the date on which financial statements are authorised for issue as 'a bright line' to distinguish temporary and long-term lack of exchangeability. Accordingly, the use of judgement would be limited only to assessing exchangeability (or a lack thereof).

(b) result in minimal change to IAS 21, which is consistent with the objective of a narrow-scope project.

C12. In addition, we continue to think the proposed definitions would be consistent with existing requirements in IAS 21.

C13. Nonetheless, this approach would have the following limitations:

(a) as explained in paragraph C9, this approach could result in an entity using a rate that would not reflect conditions existing at the reporting date when exchangeability is temporarily lacking.

(b) comparability between entities could be affected by differing dates of authorising financial statements for issue. Nonetheless, we think the same matter arises in applying the requirements in IAS 10 to any adjusting event after the reporting period.

Assessment of *Approach B*

C14. Applying this approach, an entity would not identify whether a lack of exchangeability is temporary or long-term. An entity would identify when exchangeability is lacking, and would then use a rate that reflects the conditions existing at the reporting date. Accordingly, defining temporary (or long-term) lack of exchangeability would be unnecessary.

C15. We think requiring entities to use a rate that is reflective of conditions existing at the reporting date (regardless of whether exchangeability has been restored after that date) would result in:

(c) a more principle-based approach to addressing a lack of exchangeability than *Approach A*; and

(d) improved comparability between entities in similar circumstances.

C16. This approach would also remove any concern about the interaction between any amendment and the requirements in IAS 34 (see paragraph C6 of this paper).

C17. However, this approach:

(a) would necessitate changing the requirements in paragraph 26 of IAS 21—this is because those requirements would be inconsistent with the approach.

(b) might result in more situations in which an entity would use an estimated spot rate and, thus, could increase complexity in applying IAS 21. Nonetheless, we think permitting entities to use the first subsequent observable rate when that rate approximates the estimated spot rate at the reporting date would mitigate that concern (see paragraphs 39–44 of this paper).

Staff recommendation

C18. On balance, we recommend *Approach B* because of its principle-based nature. Indeed, if the Committee agrees with the overarching principle that, when exchangeability is lacking, an entity uses a spot rate reflecting conditions existing at the reporting date, we see no conceptual reason to develop different requirements for temporary and long-term lack of exchangeability.

Other approaches considered

C19. We also considered whether, but decided not, to investigate further the following approaches:

(a) retaining a definition of temporary and long-term lack of exchangeability, but requiring an entity not to use the first subsequent observable rate if that rate would not reflect conditions existing at the reporting date. However, we see little benefit in retaining a distinction between temporary and long-term lack of exchangeability in this case. *Approach B* achieves a similar outcome with reduced complexity.

(a) retaining a definition of temporary and long-term lack of exchangeability but defining 'temporary' in terms of a specified short period of time (for example, a lack of exchangeability would be considered temporary if exchangeability had been restored by one month after the reporting date). However, specifying any such period of time would create an arbitrary rule.

Appendix D—analysis of Committee feedback on the estimation of a spot rate

Estimating the spot rate

Staff preliminary view and Committee feedback

D1. Our preliminary view was that an entity would estimate the spot rate when there is a long-term lack of exchangeability. Any amendment would neither specify how an entity estimates the spot rate nor prescribe a particular estimation technique.

D2. Committee members generally agreed that:

(a) an entity should estimate the spot rate when there is a long-term lack of exchangeability—both when reporting foreign currency transactions in the functional currency and when using a presentation currency other than the functional currency; and

(b) any amendment should only set out objectives for the estimation process and not prescribe an estimation technique. In this respect, some Committee members said any amendment should specify a clear measurement principle or objective—entities would then apply an estimation technique that meets this principle or objective. Some Committee members also said the appropriate estimation technique would depend on an entity's facts and circumstances. They therefore agreed with our preliminary view that such estimation may require the use of judgement, considering entity and jurisdiction-specific factors.

D3. One Committee member suggested considering whether to require the application of an estimation model based only on the purchase power parity theory[4]. Another member suggested providing a hierarchy of inputs an entity could consider when applying an estimation technique.

[4] We described this theory in Appendix D of Agenda Paper 3 for the May 2018 Committee meeting.

Staff analysis and response

D4. Committee members generally agreed with our preliminary views on this matter. Our analysis and recommendations of how an entity would estimate the spot rate in paragraphs 20–29 of this paper incorporates this feedback. We have made no significant changes to our preliminary view in this respect.

Applying an estimated exchange rate

D5. The Committee discussed how an entity estimates a spot rate when it is able to obtain only some amounts of foreign currency.

Staff preliminary view and Committee feedback

D6. Our preliminary view was that an entity should apply an estimated exchange rate to the entire foreign currency amount when the entity is able to obtain only some amounts of foreign currency (this is the ‘estimated rate’ approach recommended in this paper).

D7. Committee members generally agreed with this preliminary view. Nonetheless, one Committee member suggested that entities be allowed a choice of applying either the estimated approach or the blended approach.

Staff analysis and response

D8. Paragraphs 47–50 of this paper discuss why we think entities should be required to apply the estimated approach. Accordingly, we have made no significant changes to our preliminary view in this respect.