IFRS Accounting

Staff paper

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IASB® meeting

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Project	**Lack of Exchangeability (Proposed amendments to IAS 21)**
Topic	**Assessing exchangeability between two currencies**
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Purpose of this paper

1. As discussed in Agenda Paper 12 for this meeting, this paper provides our analysis of the main comments received on Question 1—assessing exchangeability between two currencies in the Exposure Draft *Lack of Exchangeability* and our recommendations for the International Accounting Standards Board (IASB).

2. Our analysis and recommendations take into account feedback in comment letters and outreach, as well as feedback from members of the Emerging Economies Group (EEG) at their May 2022 meeting.

Structure of this paper

3. This paper includes:

   (a) summary of staff recommendations;

   (b) staff analysis and recommendations related to the following aspects of assessing exchangeability between two currencies:

      (i) factors to consider;

      (ii) holistic consideration of factors;

      (iii) other comments; and

   (c) question for the IASB (included after paragraph 59).

Summary of staff recommendations

4. We recommend that the IASB:

   (a) proceed with its proposed approach to set out factors an entity would consider in assessing exchangeability and specify how those factors affect the assessment;

(b) *time frame*—retain the notion of a normal administrative delay;

(c) *ability to obtain the other currency*—make no change to this factor;

(d) *markets or exchange mechanisms*—

   (i) clarify that an entity does not consider ‘unofficial markets’ in assessing exchangeability but, when exchangeability is lacking, it can use exchange rates from these markets to estimate the spot exchange rate;

   (ii) refer to ‘rates from exchange transactions that do not create enforceable rights and obligations’ rather than ‘unofficial rates’ or ‘black market rates’;

   (iii) make no change to further define or describe ‘enforceability of rights and obligations’;

(e) *purpose of obtaining the other currency*—make no change to this factor;

(f) *ability to obtain only limited amounts of the other currency*—develop an example of the ‘aggregate method’ either as application guidance or an illustrative example; and

(g) clarify that all factors are to be considered holistically when assessing exchangeability, and the absence of one factor would indicate a lack of exchangeability.

5. Within the staff analysis set out in this paper, we also indicate particular areas of focus in drafting the amendments to IAS 21.

Staff analysis and recommendations

Factors to consider

Proposals in the Exposure Draft

6. The Exposure Draft proposed to amend IAS 21 to set out factors an entity considers in assessing exchangeability and to specify how those factors affect the assessment. Paragraphs BC4–BC16 of the Basis for Conclusions on the Exposure Draft explain the IASB’s rationale for this proposal. In particular:

(a) paragraph 8 of the Exposure Draft adds a definition of ‘exchangeable’, which states:

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

(b) paragraph BC4 of the Basis for Conclusions on the Exposure Draft states:

> Many factors influence exchangeability between two currencies. To make the definition proposed in paragraph 8 operational and to help entities apply that definition consistently, the Board is proposing to specify when an entity is able (and thus unable)

to exchange a currency for another currency. In identifying the factors required to be considered in making the assessment, the Board considered:

(a) what time frame for obtaining the other currency does an entity consider (paragraph BC5)?

(b) what if an entity is able to obtain the other currency, but does not intend to do so (paragraph BC6)?

(c) which markets or exchange mechanisms for obtaining the other currency does an entity consider (paragraph BC7)?

(d) what is the purpose for which an entity obtains the other currency (paragraphs BC8–BC12)?

(e) what if an entity is able to obtain only limited amounts of the other currency (paragraphs BC13–BC16)?

Respondents' comments

7. Many respondents agreed with the proposed definition of 'exchangeable' and the factors an entity is required to consider in assessing whether a currency is exchangeable. One respondent disagreed with the proposal, suggesting a lack of exchangeability be determined by 'the accounting association of a country as a whole'; otherwise, different entities may reach different conclusions, affecting comparability.

8. A few respondents suggested exchangeability be assessed at a jurisdiction level, rather than at an entity level—similar to assessing the existence of hyperinflation for the purpose of applying IAS 29 *Financial Reporting in Hyperinflationary Economies*.

9. At the May 2022 EEG meeting, EEG members generally agreed with the staff's suggested way forward—the assessment of exchangeability should be at an entity level. A few EEG members said it might be beneficial to state that entities in a jurisdiction experiencing similar exchangeability circumstances would be expected to reach the same conclusions.

Staff analysis and recommendations

10. In our view, it would be difficult to operationalise a requirement that 'the accounting association of a country' or another party would determine whether there is a lack of exchangeability between two currencies in the context of determining whether an entity can exchange those currencies. We expect that such an approach would fail to result in useful information for investors and would raise application questions for preparers, particularly if the methods or processes used by individual jurisdictions to make the determination lacked transparency and were very different across jurisdictions.

11. Importantly, we also note that, depending on the circumstances, one entity in a jurisdiction might be able to exchange two currencies (because of the nature, size or volume of its foreign currency

transactions or foreign operations) whereas another entity in that same jurisdiction might not. IAS 21 requires an entity-specific assessment of the effects of changes in foreign exchange rates[1]—it is consistent with that approach to also require an entity-specific assessment of exchangeability between two currencies.

12. In the context of determining the existence of hyperinflation for the purpose of applying IAS 29, economies are typically determined to be hyperinflationary from a particular date based on a macroeconomic assessment of the characteristics of the economic environment. In this respect, paragraph 4 of IAS 29 states that 'it is preferable that all entities that report in the currency of the same hyperinflationary economy apply this Standard from the same date'. Determining whether an *economy* is hyperinflationary is, however, different from determining whether an *entity* can exchange two currencies for a particular purpose. The former is—by definition—an economy-wide assessment; the latter is an entity-specific assessment.

13. Having considered respondents' feedback, we recommend that the IASB proceed with its proposed approach to set out factors an entity would consider in assessing exchangeability and to specify how those factors affect the assessment.

14. In the paragraphs below, we present and analyse respondents' comments on the proposed factors to consider in assessing exchangeability:

    (a) time frame;

    (b) ability to obtain the other currency;

    (c) markets or exchange mechanisms;

    (d) purpose of obtaining the other currency; and

    (e) ability to obtain only limited amounts of the other currency.

Time frame

Respondents' comments

15. The Exposure Draft proposed adding requirements in paragraph A5 to state:

> Paragraph 8 defines a spot exchange rate as the exchange rate for immediate delivery. However, an exchange transaction may not always complete instantaneously, because of legal or regulatory requirements applying to exchange transactions, or for practical reasons such as statutory holidays. A normal administrative delay in obtaining the other currency does not preclude a currency from being exchangeable into that other

[1] Paragraph 3 of IAS 21 states [footnote omitted] 'this 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'.

currency. What constitutes a normal administrative delay depends on facts and circumstances.

16. Some respondents suggested providing guidance on applying ‘normal administrative delay’, such as by providing indicators or factors to consider. Some respondents said in the absence of such guidance, it would be difficult to determine what ‘normal’ is, especially when—in some jurisdictions—the range of ‘normal’ timing of approval of exchange transactions may be very wide.

17. Some respondents suggested providing clarity on specific points:

    (a) whether to use the spot exchange rate on the date of requesting foreign currency or the date of obtaining foreign currency;

    (b) how normal administrative delay fits with ‘immediate delivery’ within the definition of ‘spot exchange rate’ in IAS 21; and

    (c) confirming that normal administrative delay does not refer to the time required to fix the spot exchange rate.

18. A few respondents commented on proposed Illustrative Example 1 that would accompany IAS 21. They expressed concern that without indicators or better explanation of how to apply the principles, the numerical example (seven days) could be applied as a ‘bright line’.

Staff analysis and recommendations

19. The IASB included in the proposals the notion of a ‘normal administrative delay’ to assist in making the definition of ‘exchangeable’ operational. As stated in proposed paragraph A5, a normal administrative delay depends on facts and circumstances. The IASB intended a normal administrative delay to be a short period of time but decided against being prescriptive about how long that would be. Having considered the feedback, in our view it is neither feasible nor practical for the IASB to provide detailed guidance about a normal administrative delay because the facts and circumstances will vary from one jurisdiction to another.

20. We recommend that the IASB retain the notion of a normal administrative delay. We will consider in drafting ways to clarify the relationship between ‘immediate delivery’—as that term is used in the definition of a spot exchange rate in paragraph 8 of IAS 21—and a normal administrative delay.

21. The notion of a normal administrative delay can, in our view, sit alongside what the definition of a spot exchange rate refers to as ‘immediate delivery’. We think ‘immediate delivery’ has always incorporated a short period of time to clear administrative, legal or regulatory requirements in exchanging currencies. Accordingly, an entity assesses a spot exchange rate on the date of obtaining foreign currency rather than on the date of requesting foreign currency. A normal administrative delay does not preclude a currency from being exchangeable.

22. We are persuaded by the feedback to remove the reference to seven days in proposed Illustrative Example 1 (paragraphs IE3–IE4). We will consider in drafting how to illustrate a normal administrative delay without creating a perceived 'bright line'.

Ability to obtain the other currency

Respondents' comments

23. The Exposure Draft proposed adding requirements in paragraph A6 to state:

> In assessing whether a currency is exchangeable into another currency, an entity shall consider its ability to obtain the other currency, and not its intention or decision to do so. Subject to the other requirements in paragraphs A5–A11, a currency is exchangeable into another currency if an entity is able to obtain the other currency—either directly or indirectly—even if it intends or decides not to do so. For example, subject to the other requirements in paragraphs A5–A11, currency LC is exchangeable into currency PC if an entity is able to either exchange LC for PC, or exchange LC for another currency (FC) and then exchange FC for PC, regardless of whether the entity intends or decides to obtain PC.

24. A few respondents said the meaning of being able to obtain the other currency 'indirectly' is unclear, or suggested that transactions—beyond currency-to-currency transactions—can provide evidence of exchangeability. One respondent suggested using a 'more likely than not' threshold when assessing the ability to obtain the other currency and adding a rebuttable presumption that an entity has the ability to exchange a currency when it has a legal right and means to do so, unless there is evidence to the contrary.

Staff analysis and recommendations

25. As mentioned above, proposed paragraph A6 provides an example of when a currency is indirectly exchangeable into another currency via a third currency:

> For example, subject to the other requirements in paragraphs A5–A11, currency LC is exchangeable into currency PC if an entity is able to either exchange LC for PC, or exchange LC for another currency (FC) and then exchange FC for PC, regardless of whether the entity intends or decides to obtain PC.

26. In developing the Exposure Draft, the IASB was not prescriptive about how an entity could obtain another currency or whether it could use transactions other than currency-to-currency transactions. In our view, it is not practical or helpful for the IASB to contemplate or specify which instruments or transactions an entity could use to obtain a foreign currency. We therefore recommend no change in response to these suggestions. We observe that depending on the type of transaction used to obtain another currency, an entity might determine that it does not meet other factors in the analysis for the currency to be exchangeable—for example, the transaction might take longer than a normal administrative delay or might be for only limited amounts of the other currency.

27. In our view, it would add complexity to the requirements if the IASB were to introduce a 'more likely than not' threshold when assessing an entity's ability to obtain the other currency or adding a rebuttable presumption that an entity has the ability to exchange a currency when it has a legal right and means to do so. We therefore recommend that the IASB make no change in response to these comments.

Markets or exchange mechanisms

Respondents' comments

28. The Exposure Draft proposed adding requirements in paragraph A7 to state:

> 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.

29. Some respondents supported the proposed requirements. These respondents suggested clarifying that an entity not consider unofficial (or 'parallel' or 'black') markets in assessing exchangeability but, when exchangeability is lacking, the exchange rates from these markets can be used to estimate the spot exchange rate. Some EEG members commented on challenges in referring to unofficial rates in IFRS Accounting Standards.

30. A few respondents said it is unclear what is meant by 'create enforceable rights and obligations'. These respondents suggested either defining the phrase or referring to 'legal' or 'lawful' exchange mechanisms. One respondent suggested considering the principles for 'enforceability' (of rights and obligations) in IFRS 15 *Revenue from Contracts with Customers* and IFRS 17 *Insurance Contracts*.

31. A few respondents suggested that proposed Illustrative Example 2 include the reasons for the lack of enforceability of rights and obligations in the described jurisdiction.

Staff analysis and recommendations

32. We agree with respondents' suggestion that the IASB clarify an entity does not consider unofficial (or 'parallel' or 'black') markets in assessing exchangeability but, when exchangeability is lacking, it can use exchange rates from these markets to estimate the spot exchange rate.

33. We agree with respondents' feedback about the challenges in referring to unofficial rates in IFRS Accounting Standards—unofficial rates are neither defined in IFRS Accounting Standards nor might they have the same meaning in different jurisdictions. Therefore, we recommend continuing to refer to 'rates from exchange transactions that do not create enforceable rights and obligations' rather than 'unofficial rates' or 'black market rates'.

34. Proposed paragraph A7 states that enforceability is a matter of law—which is consistent with paragraph 10 of IFRS 15 and paragraph 2 of IFRS 17. In our view, additional requirements about enforceability are not needed in the amendments to IAS 21 and would be difficult to draft in a way that would work in all circumstances. We therefore recommend that the IASB make no change to further define or describe enforceability of rights and obligations.

35. Proposed Illustrative Example 2 accompanying IAS 21 states in paragraph IE5 of the Exposure Draft:

> In the absence of this exchange mechanism, individual resellers settle transactions to exchange LC for PC at an exchange rate not set by the jurisdictional authority. However, exchange transactions with those resellers do not create enforceable rights and obligations…

36. In our view, it would not significantly aid readers' understanding of the requirements if the IASB were to add more details to Example 2, such as the reasons for the lack of enforceability of rights and obligations in the described jurisdiction—and doing so might result in an entity limiting its thinking about enforceability to the situation in the example. The assessment depends on facts and circumstances, and proposed paragraph A7 states that enforceability is a matter of law. We therefore recommend that the IASB make no change to proposed Illustrative Example 2 to include the reasons for the lack of enforceability of rights and obligations in the described jurisdiction.

Purpose of obtaining the other currency

Respondents' comments

37. The Exposure Draft proposed adding requirements in paragraphs A8–A10 to state:

> A8. Different rates might apply for different uses of a currency. For example, a jurisdiction facing pressure on its balance of payments might wish to deter capital remittances (such as dividend payments) to other jurisdictions but encourage imports of specific goods from those jurisdictions…
>
> A9. Accordingly, whether a currency is exchangeable into another currency could depend on the purpose for which the entity obtains the other currency. In assessing exchangeability, an entity shall assume the purpose of obtaining the other currency is to:
>
> (a) settle individual foreign currency transactions, assets or liabilities for foreign currency transactions reported in the entity's functional currency.
>
> (b) realise the entity's net assets for the use of a presentation currency other than the entity's functional currency.
>
> (c) realise the entity's net investment in a foreign operation for translating the results and financial position of that foreign operation.

> A10. An entity's net assets or net investment in a foreign operation might be realised by for example:
>
> (a) the distribution of a financial return to the entity's owners;
>
> (b) the receipt of a financial return from the entity's foreign operation; or
>
> (c) the entity's owners recovering their investment, such as through disposal of the investment.

38. A few respondents said it is unclear how to apply the requirements related to 'purpose', such as in situations in which there is no actual need to exchange one currency for another. These situations include, for example, translating on initial recognition non-monetary assets that will be recovered through use rather than sale and balances always settled in local currency.

39. One preparer said proposed paragraphs A9–A10 imply each entity needs to determine the exchange rate for different purposes, which could lead to a variety of exchange rates being used, and asked for clarity as to which of those 'possible' rates should be used.

Staff analysis and recommendations

40. Proposed paragraph A3 states that 'an entity shall assess whether a currency is exchangeable into the other currency separately for each reporting purpose specified in paragraph A9' and provides an example.

41. Paragraph BC6 of the Basis for Conclusions on the Exposure Draft explains that the proposal is consistent with other requirements in IAS 21—for example, the requirement to use a spot exchange rate when translating amounts into another currency regardless of an entity's intention or decision to enter into a transaction at that spot exchange rate. When assessing a lack of exchangeability, there does not have to be an 'actual need' to exchange one currency for another.

42. We therefore recommend that the IASB make no change in response to respondents' comments about the purpose of obtaining the other currency.

Ability to obtain only limited amounts of the other currency

Respondents' comments

43. The Exposure Draft proposed adding requirements in paragraph A11 to state:

> An entity may be able to obtain only limited amounts of the other currency. For example, an entity with a liability denominated in a foreign currency (FC1,000) may be able to obtain only FC50 to settle that liability. In such circumstances, a currency is not exchangeable into another currency when, for a purpose specified in paragraph A9, an entity is able to obtain no more than an insignificant amount of the other currency. An entity shall assess the significance of the amount of the other currency it is able to obtain for a specified purpose by comparing that amount with the total amount of the other currency required for that purpose.

44. Some respondents requested additional guidance on how to apply ‘no more than an insignificant amount’.

45. Other comments include:

(a) it is unclear whether, in applying this factor, balances should be aggregated by nature and risks;

(b) the link between the purpose of obtaining the other currency in proposed paragraph A9 and the ability to obtain only limited amounts of the other currency in proposed paragraph A11 is unclear;

(c) the proposed 'no more than insignificant' threshold in determining a lack of exchangeability is too low. It is narrower than the approach in IFRS 13 *Fair Value Measurement* when the volume or level of activity for an asset or liability has significantly decreased (referred to in paragraph BC14 of the Basis for Conclusions on the Exposure Draft);

(d) the requirement in proposed paragraph A11 might result in entities reaching different conclusions depending on the size of their operations and transactions involved; and

(e) how to apply the aggregate model is unclear. One respondent said paragraphs BC15–BC16 of the Basis for Conclusions on the Exposure Draft provide an example that could be included in the Standard for clarity.

Staff analysis and recommendations

46. Paragraphs BC13–BC16 of the Basis for Conclusions on the Exposure Draft explain the IASB’s decisions in proposing that an entity consider its ‘ability to obtain only limited amounts of the other currency’—an entity should use the ‘aggregate method’ to assess the significance of the amount of the other currency the entity is able to obtain for a specified purpose. Proposed paragraph A11 includes the requirement for an entity to use what the basis refers to as the aggregate method:

> An entity shall assess the significance of the amount of the other currency it is able to obtain for a specified purpose by comparing that amount with the total amount of the other currency required for that purpose.

47. As stated in paragraph A11, the assessment is done ‘for a specified purpose’; an entity may need to assess exchangeability between two currencies for more than one purpose.

48. In response to respondents’ suggestions, we recommend that the IASB incorporate the example of the ‘four trade payable balances’ (or something similar) from paragraph BC15 into either the application guidance in IAS 21 or as an illustrative example accompanying IAS 21 to further illustrate the ‘aggregate method’. We will also consider in drafting how best to avoid creating bright lines through examples.

Holistic consideration of factors

Proposals in the Exposure Draft

49. The Exposure Draft requires an entity to consider all factors in proposed paragraphs A2–A11 in assessing exchangeability.

Respondents' comments

50. Feedback indicates that some respondents read the proposals to say that, in assessing exchangeability, each of the factors would be considered individually or separately, instead of holistically. If considered individually or separately, questions then arise about the interaction between the factors.

51. Some respondents suggested clarifying:

(a) how to assess exchangeability when there are multiple exchange rates;

(b) the frequency of assessing exchangeability;

(c) whether proxies and implied exchange rates can be used to assess exchangeability; and

(d) whether the absence of one of the factors considered in assessing exchangeability would indicate a lack of exchangeability.

52. At the May 2022 EEG meeting, EEG members agreed with the staff's suggested way forward—an entity needs to consider holistically all the proposed factors in assessing exchangeability.

Staff analysis and recommendations

53. Paragraphs A2–A3 of the Exposure Draft 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…

54. In our view, these paragraphs convey that all the factors are to be considered holistically when assessing exchangeability. This means that the absence of one of the factors considered in assessing exchangeability would indicate a lack of exchangeability. We recommend that the IASB clarify this in the amendments to IAS 21.

55. Proposed paragraph A2 also explained in the words ‘at a measurement date’ that the frequency of assessing exchangeability is directly linked to an entity’s reporting requirements—an entity would make that assessment whenever it is measuring its assets, liabilities, income and expenses in preparing its financial statements.

56. In our view, questions about multiple exchange rates and implied exchange rates are addressed by the proposed requirements on ‘markets and exchange mechanisms’ and the ‘purpose of obtaining the other currency’.

Other comments

Respondents’ comments

57. Other comments include the following:

    (a) some respondents suggested using or adding wording proposed as application guidance within the definition of ‘exchangeable’; and

    (b) a few respondents said exchangeability is often only lacking in one direction and suggested amending the definition of ‘exchangeable’ to clarify that a currency is exchangeable when an entity is able to ‘buy and sell’ the currency.

Staff analysis and recommendations

58. Having considered the feedback, in our view the proposed requirements for assessing exchangeability between two currencies would be clarified by including the content in paragraphs A2–A3 of the Exposure Draft in the body of the Standard rather than in the application guidance. Some respondents were confused by the lack of requirements in the body of the Standard for ‘Step I–assessing exchangeability between two currencies’; all the requirements for Step I are in the application guidance in the Exposure Draft. Therefore, in drafting we will consider including the content in paragraphs A2–A3 of the Exposure Draft in the body of the Standard rather than in the application guidance.

59. We agree with respondents that exchangeability might be lacking in only one direction—for example, an entity that is unable to obtain US dollars in exchange for transferring another currency may, nonetheless, find it easy to obtain that other currency in exchange for transferring US dollars. We will consider in drafting whether any change is required to the wording of the requirements in this respect.

Question for the IASB

Does the IASB agree with our recommendations set out in paragraph 4 to:

(a) proceed with its proposed approach to set out factors an entity would consider in assessing exchangeability and specify how those factors affect the assessment;

(b) *time frame*—retain the notion of a normal administrative delay;

(c) *ability to obtain the other currency*—make no change to this factor;

(d) *markets or exchange mechanisms*—

(i) clarify that an entity does not consider 'unofficial markets' in assessing exchangeability but, when exchangeability is lacking, it can use exchange rates from these markets to estimate the spot exchange rate;

(ii) refer to 'rates from exchange transactions that do not create enforceable rights and obligations' rather than 'unofficial rates' or 'black market rates';

(iii) make no change to further define or describe 'enforceability of rights and obligations';

(e) *purpose of obtaining the other currency*—make no change to this factor;

(f) *ability to obtain only limited amounts of the other currency*—develop an example of the 'aggregate method' either as application guidance or an illustrative example; and

(g) clarify that all factors are to be considered holistically when assessing exchangeability, and the absence of one factor would indicate a lack of exchangeability.