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IFRS® Standards
Exposure Draft ED/2021/4

Lack of Exchangeability

Comments to be received by 1 September 2021

IASB®

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Exposure Draft

Lack of Exchangeability

Proposed amendments to IAS 21

Comments to be received by 1 September 2021

Exposure Draft ED/2021/4 *Lack of Exchangeability* is published by the International Accounting Standards Board (Board) for comment only. Comments need to be received by **1 September 2021** and should be submitted by email to commentletters@ifrs.org or online at https://www.ifrs.org/projects/open-for-comment/.

All comments will be on the public record and posted on our website at www.ifrs.org unless the respondent requests confidentiality. Such requests will not normally be granted unless supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data.

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Introduction

In this Exposure Draft, the International Accounting Standards Board (Board) proposes to amend IAS 21 *The Effects of Changes in Foreign Exchange Rates*. The amendments would specify:

(a) when a currency is exchangeable into another currency and, consequently, when it is not;

(b) how an entity determines the exchange rate to apply when a currency is not exchangeable; and

(c) the information an entity provides when a currency is not exchangeable.

Why is the Board publishing this Exposure Draft?

IAS 21 generally requires the use of a spot exchange rate when an entity reports foreign currency transactions or a foreign operation's results and financial position in its financial statements. A spot exchange rate is the exchange rate for immediate delivery. IAS 21 specifies the exchange rate to use in reporting foreign currency transactions when exchangeability between two currencies is temporarily lacking. However, the Standard does not specify what an entity is required to do when a lack of exchangeability is not temporary.

The IFRS Interpretations Committee (Committee) considered how an entity determines the exchange rate to use in translating a foreign operation's results and financial position when the foreign operation's functional currency is not exchangeable into the presentation currency. The Committee was informed of diverse views on how to determine whether a currency is exchangeable into another currency and the exchange rate to use when it is not. Although circumstances in which a currency is not exchangeable might arise relatively infrequently, when they do arise economic conditions can deteriorate rapidly. In those circumstances, the diverse views on the application of IAS 21 could lead to material differences in the financial statements of entities affected by a currency that lacks exchangeability. The Board is therefore proposing to add requirements to IAS 21 for an entity to determine whether a currency is exchangeable into another currency, and accounting requirements to apply when it is not.

Invitation to comment

The Board invites comments on the proposals in this Exposure Draft, particularly on the questions set out below. Comments are most helpful if they:

(a) address the questions as stated;

(b) indicate the specific paragraph(s) to which they relate;

(c) contain a clear rationale;

(d) identify any wording in the proposals that is difficult to translate; and

(e) include any alternative the Board should consider, if applicable.

The Board is requesting comments only on matters addressed in this Exposure Draft.

Questions for respondents

Question 1—Assessing exchangeability between two currencies

Paragraph 8 of the draft amendments to IAS 21 specifies that a currency is exchangeable into another currency when an entity is able to exchange that currency for the other currency. Paragraphs A2–A11 of [draft] Appendix A to IAS 21 set out factors an entity considers in assessing exchangeability and specify how those factors affect the assessment.

Paragraphs BC4–BC16 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Question 2—Determining the spot exchange rate when exchangeability is lacking

Paragraphs 19A–19C and paragraphs A12–A15 of the draft amendments to IAS 21 specify how an entity determines the spot exchange rate when a currency is not exchangeable into another currency.

Paragraphs BC17–BC20 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Question 3—Disclosure

Paragraphs 57A–57B and A16–A18 of the draft amendments to IAS 21 require an entity to disclose information that would enable users of its financial statements to understand how a lack of exchangeability between two currencies affects, or is expected to affect, its financial performance, financial position and cash flows.

Paragraphs BC21–BC23 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Question 4—Transition

Paragraphs 60L–60M of the draft amendments to IAS 21 require an entity to apply the amendments from the date of initial application, and permit earlier application.

Paragraphs BC24–BC27 of the Basis for Conclusions explain the Board's rationale for this proposal.

Do you agree with this proposal? Why or why not? If you disagree with the proposal, please explain what you suggest instead and why.

Deadline

The Board will consider all written comments received by 1 September 2021.

How to comment

Please submit your comments electronically:

Online	https://www.ifrs.org/projects/open-for-comment/
By email	commentletters@ifrs.org

Your comments will be on the public record and posted on our website unless you request confidentiality and we grant your request. We do not normally grant such requests unless they are supported by a good reason, for example, commercial confidence. Please see our website for details on this policy and on how we use your personal data.

[Draft] Amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates*

Paragraphs 8 and 26 are amended. Paragraphs 19A–19C and their related heading, paragraphs 57A–57B, 60L–60M and Appendix A are added. The definitions of 'closing rate' and 'spot exchange rate' in paragraph 8 have not been amended but have been included for ease of reference. Deleted text is struck through and new text is underlined. For ease of reading, text in Appendix A has not been underlined.

Definitions

8 **The following terms are used in this Standard with the meanings specified:**

Closing rate **is the spot exchange rate at the end of the reporting period.**

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

…

Spot exchange rate **is the exchange rate for immediate delivery.**

…

Determining the spot exchange rate when exchangeability is lacking

19A 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.

19B 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).

19C The requirements in paragraphs A12–A15 specify how an entity applies paragraphs 19A–19B in determining the spot exchange rate when a currency is not exchangeable into another currency.

Reporting foreign currency transactions in the functional currency

...

Reporting at the ends of subsequent reporting periods

...

26 When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. ~~If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.~~

...

Disclosure

...

57A When an entity estimates a spot exchange rate because exchangeability between two currencies is lacking (see paragraph 19A), the entity shall disclose information that enables users of its financial statements to understand how the lack of exchangeability affects, or is expected to affect, the entity's financial performance, financial position and cash flows. To achieve this objective, an entity shall disclose information about:

(a) the nature and financial effects of the lack of exchangeability;

(b) the spot exchange rate(s) used;

(c) the estimation process; and

(d) the risks to which the entity is exposed because of the lack of exchangeability.

57B The requirements in paragraphs A16–A18 specify how an entity applies paragraph 57A.

Effective date and transition

...

60L *Lack of Exchangeability*, issued in [Month, Year], amended paragraphs 8 and 26 and added paragraphs 19A–19C and 57A–57B and Appendix A. An entity shall apply those amendments from the beginning of annual reporting periods beginning on or after [date to be decided after exposure]. Earlier application is permitted. The date of initial application is the beginning of the annual reporting period in which an entity first applies those amendments.

60M In applying *Lack of Exchangeability*, an entity shall not restate comparative information. Instead:

(a) when the entity reports foreign currency transactions in its functional currency, and exchangeability between its functional currency and the foreign currency is lacking (as described in paragraphs A2–A11), the entity shall:

(i) translate affected 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 amendments as an adjustment to the opening balance of retained earnings at the date of initial application;

(b) when the entity uses a presentation currency other than its functional currency or translates the results and financial position of a foreign operation, and exchangeability between its presentation currency and its functional currency (or the foreign operation's functional currency) is lacking (as described in paragraphs A2–A11), the entity shall:

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

(ii) translate affected 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 amendments as an adjustment to the cumulative amount of translation differences —accumulated in a separate component of equity— at the date of initial application.

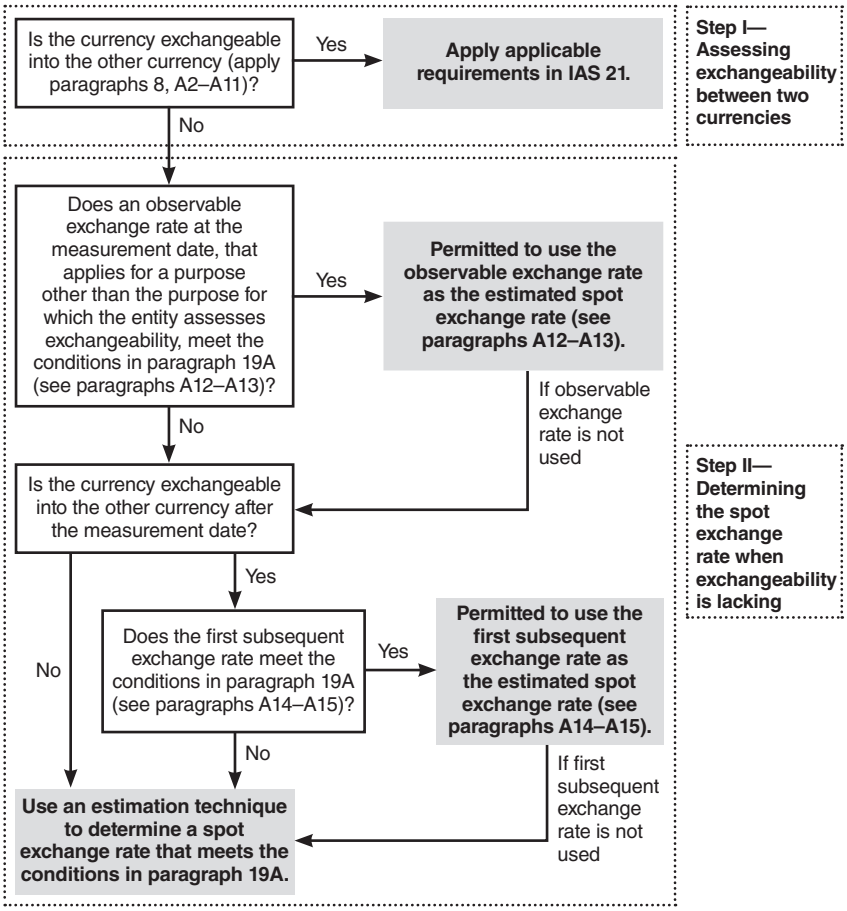
...

Appendix A
Application guidance

This appendix is an integral part of the Standard.

Exchangeability and a lack of exchangeability

A1 The following diagram may assist entities in assessing whether a currency is exchangeable into another currency and, when it is not, in applying the applicable requirements.



Step I—Assessing exchangeability between two currencies

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. For example, an entity shall assess exchangeability for the purpose of reporting foreign currency transactions in its functional currency (see paragraph A9(a)) separately from exchangeability for the purpose of translating the results and financial position of a foreign operation (see paragraph A9(c)).

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

Time frame

A5 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 currency. What constitutes a normal administrative delay depends on facts and circumstances.

Ability to obtain the other currency

A6 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.

Markets or exchange mechanisms

A7 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.

Purpose of obtaining the other currency

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. In such circumstances, the jurisdictional authorities might:

(a) set a preferential exchange rate for imports of those goods and a 'penalty' exchange rate for capital remittances to other jurisdictions, thus resulting in different exchange rates applying to different exchange transactions; or

(b) make the other currency available only to pay for imports of those goods and not for capital remittances to other 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.

Ability to obtain only limited amounts of the other currency

A11 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.

Step II—Determining the spot exchange rate when exchangeability is lacking (paragraphs 19A–19B)

Using an observable exchange rate

A12 A currency that is not exchangeable into another currency for one purpose may be exchangeable into that currency for another purpose. For example, an entity may be able to obtain a currency to import specific goods but not to pay dividends. In such situations, an entity might conclude that an observable exchange rate for another purpose meets the conditions in paragraph 19A

and, when the rate does so, the entity may use that rate as the estimated spot exchange rate.

A13 In assessing whether such an observable exchange rate meets the conditions in paragraph 19A, an entity shall consider, among other factors:

(a) *whether several exchange rates exist*—the existence of more than one observable exchange rate may indicate that exchange rates are set to encourage, or deter, entities from obtaining the other currency for particular purposes. Accordingly, these observable exchange rates may include an 'incentive' or 'penalty' and therefore may not faithfully reflect the prevailing economic conditions.

(b) *the purpose for which the currency is exchangeable*—if an entity is able to obtain the other currency only for limited purposes (such as to import emergency supplies), the observable exchange rate may not faithfully reflect the prevailing economic conditions.

(c) *the nature of the exchange rate*—a free-floating observable exchange rate is more likely to faithfully reflect the prevailing economic conditions than an exchange rate set through regular interventions from the relevant monetary or jurisdictional authorities.

(d) *the frequency with which exchange rates are updated*—an observable exchange rate unchanged over time is less likely to faithfully reflect the prevailing economic conditions than an observable exchange rate updated more frequently (for example, one or more times a day).

Using the first subsequent exchange rate

A14 A currency that is not exchangeable into another currency at the measurement date might subsequently become exchangeable into that currency. In such situations, an entity might conclude that the first subsequent exchange rate meets the conditions in paragraph 19A, and when the rate does so, the entity may use that rate as the estimated spot exchange rate.

A15 In assessing whether the first subsequent exchange rate meets the conditions in paragraph 19A, an entity shall consider, among other factors:

(a) *the time between the measurement date and the date at which exchangeability is restored*—the shorter this period, the more likely the first subsequent exchange rate will faithfully reflect the prevailing economic conditions.

(b) *inflation rates*—when an economy is hyperinflationary (as specified in IAS 29 *Financial Reporting in Hyperinflationary Economies*) or is otherwise subject to high inflation, prices often change quickly and might change several times a day. Accordingly, the first subsequent exchange rate for a currency of such an economy may not faithfully reflect the prevailing economic conditions.

Disclosure when exchangeability is lacking

A16 An entity shall consider the detail necessary to satisfy the disclosure objective in paragraph 57A. An entity shall disclose the information specified in paragraphs A17–A18 and any additional information necessary to meet the objective in paragraph 57A. An entity need not duplicate information required by paragraphs A17–A18 if it has provided the information elsewhere in its financial statements.

A17 In applying paragraph 57A, an entity shall disclose:

(a) the currency and a description of the restrictions that result in that currency not being exchangeable into the other currency;

(b) a description of affected transactions;

(c) the carrying amount of affected assets and liabilities;

(d) the spot exchange rates used and whether those rates are:

(i) observable exchange rates (as permitted by paragraph 19B); or

(ii) spot exchange rates determined using an estimation technique;

(e) a description of any estimation technique the entity has used, 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 the lack of exchangeability, and the nature and carrying amount of assets and liabilities exposed to each type of risk.

A18 When a foreign operation's functional currency is not exchangeable into the presentation currency, an entity shall also disclose:

(a) the name of the foreign operation, whether the foreign operation 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 the foreign operation, including events or circumstances that could expose the entity to a loss.

[Draft] Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph 39AH is added and paragraphs 31C and D27 are amended. Deleted text is struck through and new text is underlined.

Presentation and disclosure

...

Explanation of transition to IFRSs

...

Use of deemed cost after severe hyperinflation

31C If an entity elects to measure assets and liabilities at fair value and to use that fair value as the deemed cost in its opening IFRS statement of financial position because of severe hyperinflation (see paragraphs D26–D30), the entity's first IFRS financial statements shall disclose an explanation of how, and why, the entity had, and then ceased to have, a functional currency that is subject to severe hyperinflation. ~~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.~~

...

Effective date

...

39AH *Lack of Exchangeability*, issued in [Month, Year], amended paragraphs 31C and D27. An entity shall apply those amendments for annual reporting periods beginning on or after [date to be decided after exposure]. Earlier application is permitted.

...

Appendix D
Exemptions from other IFRSs

...

Severe hyperinflation

...

D27 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 is not exchangeable into ~~and~~ a relatively stable foreign currency ~~does not exist~~. Exchangeability is assessed by applying IAS 21.

Approval by the Board of Exposure Draft *Lack of Exchangeability* published in April 2021

The Exposure Draft *Lack of Exchangeability*, which proposes amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates*, was approved for publication by all 13 members of the International Accounting Standards Board.

Hans Hoogervorst	Chairman
Suzanne Lloyd	Vice-Chair
Nick Anderson	
Tadeu Cendon	
Martin Edelmann	
Françoise Flores	
Zach Gast	
Jianqiao Lu	
Bruce Mackenzie	
Thomas Scott	
Rika Suzuki	
Ann Tarca	
Mary Tokar	

[Draft] Illustrative Examples accompanying IAS 21

[Draft] Illustrative Examples accompanying IAS 21 have been added. For ease of reading, new text is not underlined.

These examples accompany, but are not part of, IAS 21. They illustrate aspects of IAS 21 but are not intended to provide interpretative guidance.

Introduction

IE1 These examples illustrate how an entity might apply some of the requirements in IAS 21 in hypothetical situations based on the limited facts presented. Although some aspects of the examples may be present in actual fact patterns, fact patterns in those examples are simplified, and an entity would need to evaluate all relevant facts and circumstances when applying IAS 21.

Lack of exchangeability

IE2 Examples 1–3 illustrate how an entity assesses exchangeability between two currencies (Step I as set out in paragraphs A2–A11 of Appendix A). Example 4 illustrates how an entity determines the spot exchange rate when exchangeability is lacking (Step II as set out in paragraphs A12–A15 of Appendix A). In all four examples:

(a) Entity X has a functional and presentation currency of PC. Entity X prepares consolidated financial statements.

(b) Entity X has a subsidiary, Entity Y, that is a foreign operation. Entity Y's functional currency is LC, the currency of the jurisdiction in which Entity Y operates. The relevant jurisdictional authority administers the exchangeability of LC for other currencies.

Step I—Assessing exchangeability between two currencies (paragraphs 8, A2–A11)

Example 1—Time frame

IE3 The relevant jurisdictional authority in Entity Y's jurisdiction makes PC available to entities in exchange for LC only after they have completed an administrative process. Entities wishing to obtain PC must explain how they intend to use PC when submitting a request for it. In usual circumstances, an entity obtains PC after seven days—that is, seven days is the time the jurisdictional authority needs to perform checks and provide PC.

IE4 Entity X considers seven days to be a normal administrative delay applying to a transaction to exchange LC for PC through this mechanism. Subject to the other requirements in paragraphs A2–A11, Entity X considers LC to be exchangeable into PC if Entity X is able to obtain PC within seven days of requesting it.

Example 2—Markets or exchange mechanisms

IE5 The jurisdictional authority in Entity Y's jurisdiction is unable to meet demand for PC and temporarily stops making PC available through the exchange mechanism it administers. 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, and no other markets or exchange mechanisms exist in which a transaction to exchange LC for PC would create such rights and obligations.

IE6 In assessing whether LC is exchangeable into PC, Entity X considers only markets or exchange mechanisms in which a transaction to exchange LC for PC would create enforceable rights and obligations. Entity X concludes that LC is not exchangeable into PC because the exchange transactions with individual resellers do not create enforceable rights and obligations, and no other markets or exchange mechanisms exist in which a transaction to exchange LC for PC would create such rights and obligations.

Example 3—Purpose of obtaining the other currency

IE7 The jurisdictional authority in Entity Y's jurisdiction prevents entities from obtaining PC for purposes other than importing food and medicine.

IE8 In translating the results and financial position of Entity Y, Entity X considers whether it is able to obtain PC for the purpose of realising its net investment in Entity Y. Because Entity X is prevented from obtaining PC for this purpose, Entity X concludes that LC is not exchangeable into PC. Entity X's ability to obtain PC for the purpose of importing food and medicine is irrelevant to the assessment.

Step II—Determining the spot exchange rate when exchangeability is lacking (paragraphs 19A–19B and A12–A15)

Example 4—Using an observable exchange rate

IE9 The jurisdictional authority in Entity Y's jurisdiction prevents entities from obtaining PC for a purpose that would result in the realisation of a net investment in an entity operating in that jurisdiction. Other than that restriction, entities are able to obtain PC and the LC:PC exchange rate is free-floating. Only one exchange rate applies to transactions for exchanges of LC for PC; it is updated several times a day.

IE10 Because Entity X is unable to obtain PC to realise its net investment in Entity Y, Entity X concludes that LC is not exchangeable into PC.

IE11 In estimating the spot exchange rate as required by paragraph 19A, Entity X considers whether it might use the observable LC:PC exchange rate. To do so, it assesses whether that observable exchange rate meets the conditions in paragraph 19A for the purpose of realising its net investment in Entity Y. In doing so, Entity X considers:

(a) *whether several exchange rates exist*—only one observable exchange rate exists between LC and PC.

(b) *the purpose for which the currency is exchangeable*—Entity X is able to obtain PC for any transaction other than a transaction that would result in the realisation of its net investment in Entity Y.

(c) *the nature of the exchange rate*—the observable exchange rate is free-floating.

(d) *the frequency with which exchange rates are updated*—the observable exchange rate is updated several times a day.

IE12 Considering these factors, Entity X determines that the observable exchange rate meets the conditions in paragraph 19A for the purpose of realising Entity X's net investment in Entity Y. Entity X may therefore use that observable exchange rate as the estimated spot exchange rate when it translates the results and financial position of Entity Y.

Basis for Conclusions on Exposure Draft *Lack of Exchangeability*

This Basis for Conclusions accompanies, but is not part of, the Exposure Draft Lack of Exchangeability. *It summarises the considerations of the International Accounting Standards Board (Board) when developing the Exposure Draft. Individual Board members gave greater weight to some factors than to others.*

Background

BC1 IAS 21 *The Effects of Changes in Foreign Exchange Rates* generally requires the use of a spot exchange rate when an entity reports foreign currency transactions or a foreign operation's results and financial position in its financial statements. A spot exchange rate is the exchange rate for immediate delivery. IAS 21 specifies the exchange rate to use in reporting foreign currency transactions when exchangeability between two currencies is temporarily lacking. However, IAS 21 contains no requirements that apply when a lack of exchangeability is not temporary.

BC2 The IFRS Interpretations Committee (Committee) considered how to determine the exchange rate to use in translating a foreign operation's results and financial position when the foreign operation's functional currency is not exchangeable into the presentation currency. The Committee was informed of diverse views on how to determine whether a currency is exchangeable into another currency and the exchange rate to use when it is not. Although circumstances in which a currency is not exchangeable might arise relatively infrequently, when they do arise economic conditions can deteriorate rapidly. In those circumstances, the diverse views on the application of IAS 21 could lead to material differences in the financial statements of entities affected by a currency that lacks exchangeability. The Committee therefore recommended that the Board add requirements to IAS 21 for an entity to determine whether a currency is exchangeable into another currency and the accounting requirements to apply when it is not. The Board agreed with the Committee's recommendation.

BC3 The proposed amendments would improve the usefulness of the information provided to users of financial statements by requiring entities to apply a consistent approach to determining whether a currency is exchangeable into another currency and the spot exchange rate to use when it is not.

Proposed amendments to IAS 21

Step l—Assessing exchangeability between two currencies

BC4 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)?

Time frame

BC5 Proposed paragraph A5 reflects the Board's conclusion that a normal administrative delay in obtaining the other currency does not preclude a currency from being exchangeable into that other currency. Ignoring normal administrative delays would, in the Board's view, lead to entities inappropriately concluding that exchangeability is lacking when a currency would, in effect, be exchangeable into that other currency. The Board decided not to propose application guidance on what would constitute a 'normal administrative delay'—this assessment would depend on facts and circumstances (for example, the jurisdiction in which an exchange transaction occurs and the type of exchange mechanism).

Ability to obtain the other currency

BC6 The Board decided that assessing whether a currency is exchangeable into another currency should depend on an entity's ability to obtain the other currency, and not its intention or decision to do so. For example, a currency can be exchangeable into another currency for the purpose of realising an entity's net investment in a foreign operation even if the entity has no intention of entering into a transaction that would result in realising that net investment. This 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.

Markets or exchange mechanisms

BC7 The Board considered whether to require an entity to consider specified markets or exchange mechanisms (for example, government-administered exchange mechanisms) when assessing exchangeability. The Board observed that the nature and type of markets or exchange mechanisms can vary between jurisdictions and, accordingly, decided that it would be more appropriate to require entities to consider only markets or exchange mechanisms in which a transaction to exchange one currency for another would create enforceable rights and obligations.

Purpose of obtaining the other currency

BC8 In many jurisdictions (particularly where exchange rates are free-floating), only one exchange rate exists between two currencies—the purpose for which an entity intends to use the other currency would neither change the exchange rate nor affect the entity's ability to obtain that other currency. However, for some currencies different exchange rates apply for different uses, which could affect an entity's ability to obtain those currencies. The Board therefore concluded that it is important for an entity to consider the purpose for which it obtains the other currency when assessing exchangeability.

BC9 The Board considered 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 the results and financial position of a foreign operation.

BC10 Paragraphs 20–37 of IAS 21 specify requirements for reporting foreign currency transactions in the functional currency. Those requirements apply to individual foreign currency transactions, and monetary and non-monetary items relating to those transactions. The Board decided that, when reporting foreign currency transactions, an entity should assess a currency's exchangeability separately for each individual transaction, asset or liability—that is, an entity would assume the purpose of obtaining foreign currency is to settle the individual foreign currency transaction, asset or liability. An entity would therefore assess whether it is able to obtain the other currency to settle the transaction, or the asset or liability related to that transaction. Requiring entities to assess each individual transaction, asset or liability would not create a new assessment, because paragraph 26 of IAS 21 already requires an entity to do so when several exchange rates are available.

BC11 Paragraphs 38–49 of IAS 21 specify requirements for the use of a presentation currency other than the functional currency and for translating the results and financial position of a foreign operation. Those requirements apply to all assets and liabilities (that is, the net assets)—and not to individual assets or liabilities—of an entity or its foreign operation. The Board therefore decided that, in these situations, an entity should assess exchangeability from the perspective of a transaction that would result in realising its net assets or net investment in the foreign operation.

BC12 The Board also considered whether:

(a) specifying that the purpose of obtaining the other currency is to realise an entity's net assets (or net investment in a foreign operation) might result in identifying many currencies that are not exchangeable because of delays that might exist when remitting dividends from some jurisdictions. The Board noted that delays in remitting dividends would not necessarily result in a conclusion that a currency is not exchangeable into the other currency—that delay might reflect a normal administrative delay. Neither would concluding that a

currency is not exchangeable into another currency automatically require an entity to use an estimation technique (see paragraph BC19).

(b) to require an entity to consider its ability to realise its net assets (or net investment in a foreign operation) over time rather than in a single transaction because an entity might often be unable to do so in a single transaction. Considering a single transaction that would result in realising an entity's net assets or net investment in a foreign operation aligns with the requirements in IAS 21 (see paragraph BC11). The Board also noted that, applying proposed paragraph A11, a currency would be exchangeable into another currency even if an entity is unable to obtain the entire amount, but is able to obtain more than an insignificant amount, of the other currency required to realise its net assets or net investment in a foreign operation.

Ability to obtain only limited amounts of the other currency

BC13 An entity might 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) might be able to obtain only FC50 to settle that liability. In deciding how to define exchangeability, the Board considered four alternatives with respect to the amount of the other currency obtainable. A currency could be exchangeable into another currency when an entity is able to obtain:

(a) any amount of that other currency (Alternative I);

(b) more than an insignificant amount of that other currency (Alternative II);

(c) more than a significant amount of that other currency (Alternative III); or

(d) the entire amount of that other currency (Alternative IV).

BC14 The Board decided to propose Alternative II, because:

(a) Alternative I would be very narrow and would lead to a lack of exchangeability only in the most extreme situations. Alternative I would therefore limit some of the benefits of the proposed amendments.

(b) Alternative IV would lead to a lack of exchangeability in many situations, which could cause unintended consequences.

(c) Alternative II would have a narrower scope than Alternative III (therefore Alternative II aligns more closely with the Board's view that an entity should estimate the spot exchange rate only in a narrow set of circumstances).

(d) Alternative II is similar to the approach in IFRS 13 *Fair Value Measurement* when the volume or level of activity for an asset or liability has significantly decreased (paragraphs B37–B42 of IFRS 13). Measuring fair value when there are few market transactions is similar in many respects to determining an appropriate spot exchange rate when an entity is able to obtain only limited amounts of the other

currency. When measuring an asset or liability's fair value, a reduced volume or level of market activity may lead an entity to depart from using unadjusted observable prices. Similarly, the Board's proposal (Alternative II) is that an entity would depart from using the observable spot exchange rate—and instead estimate the spot exchange rate—when the activity in the market in which it obtains the other currency is so low that it is able to obtain only an insignificant amount of that other currency.

BC15 When an entity reports foreign currency transactions in its functional currency and is unable to obtain the entire amount of the currency required to settle those transactions and balances, a question arises about the level at which the entity assesses exchangeability. For example, an entity with a functional currency of LC has four trade payable balances denominated in FC. The balance of each payable is FC25 and therefore the sum of the balances is FC100. The entity would be able to obtain a total amount of FC25 for the purpose of settling those transactions. In this case, does the entity:

(a) consider each payable separately? If so, the entity would need to allocate the available FC25 to each of the four payables, for example:

  (i) on a residual basis—that is, by allocating FC25 to one payable and nothing to the other three payables. The entity would therefore conclude LC is exchangeable into FC for one payable and not exchangeable into FC for the other three payables (residual method); or

  (ii) on a relative basis—that is, by allocating FC6.25 (FC25 ÷ 4) to each payable. The entity would therefore assess, for each payable, whether FC6.25 is more than insignificant in relation to the FC25 payable balance. The entity would conclude that LC is exchangeable into FC for either all or none of the payables (relative method).

(b) consider the payables on an aggregated basis? If so, the entity would assess whether the total amount of FC obtainable (FC25) is more than insignificant when compared with the aggregated amount of the payables' balances (FC100). The entity would again conclude that LC is exchangeable into FC for either all or none of the payables (aggregate method).

BC16 In the Board's view, the relative method would provide information that more faithfully represents the circumstances than would the residual method. The Board also noted that the outcomes of the relative method and the aggregate method are the same, but concluded that the aggregate method would be easier for entities to apply. The Board is therefore proposing that, when an entity assesses the significance of the amount of the other currency the entity is able to obtain for a specified purpose, it would do so by comparing that amount with the total amount of the other currency required for that purpose.

Step II—Determining a spot exchange rate

BC17 IAS 21 generally requires an entity to apply a spot exchange rate when reporting foreign currency transactions in its functional currency, using a presentation currency other than its functional currency or translating the results and financial position of a foreign operation. When a currency is not exchangeable into another currency, an entity is unable to observe the spot exchange rate. The Board is therefore proposing to specify how an entity determines the spot exchange rate in those circumstances.

BC18 The Board decided to propose conditions to be met when estimating a spot exchange rate. The Board 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. Those models vary in complexity and in the economic factors they use as inputs (for example, inflation, interest rates, the balance of payments or a jurisdiction's productivity). 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 (see paragraphs BC21–BC22).

(e) such an approach is consistent with the measurement requirements in other IFRS Standards. For example, IFRS 9 *Financial Instruments* specifies no particular technique for the measurement of expected credit losses, but instead sets out a clear objective.

Using an observable exchange rate

BC19 The Board noted that when a currency is not exchangeable into another currency, an entity would not necessarily need to use a complex estimation technique. In some situations an entity could estimate the spot exchange rate by starting with an observable exchange rate and adjusting that rate, as necessary, to estimate the spot exchange rate as proposed in paragraph 19A. To reduce complexity, the Board also decided to explicitly permit an entity to use an observable exchange rate as the estimated spot exchange rate in two situations if that observable exchange rate would meet the conditions in proposed paragraph 19A. To help entities assess whether an observable

exchange rate would meet those conditions, the Board is proposing to specify a non-exhaustive list of factors.

Other considerations

BC20 When an entity is able to obtain only limited amounts of the other currency, the Board considered whether the entity should be permitted or required to use a blended exchange rate (that is, a weighted average exchange rate reflecting both the rate at which the entity could obtain the other currency for a portion of the transaction or balance and an estimated exchange rate for the remaining portion). The Board decided not to permit or require the use of such a rate because:

(a) determining a blended exchange rate could be difficult, thereby increasing costs for preparers without providing significant additional benefits.

(b) in determining a blended exchange rate, an entity would use the observable spot exchange rate only for an insignificant portion of the transaction or balance and the estimated spot exchange rate for the remaining portion. The entity would do so because applying the requirements in proposed paragraph A11, the entity would conclude that a currency is not exchangeable only when the entity is able to obtain no more than an insignificant amount of the other currency. Therefore, in most cases the Board expects a blended exchange rate not to differ significantly from the estimated spot exchange rate.

Disclosure

BC21 Estimating a spot exchange rate when exchangeability between two currencies is lacking could materially affect an entity's financial statements. That estimation would also require the use of judgements and assumptions. The Board was informed that users of financial statements are interested not only in the effect on the financial statements of estimating the spot exchange rate, but in understanding an entity's exposure to a currency that lacks exchangeability. Users of financial statements said information about the nature and financial effects of a lack of exchangeability, the spot exchange rate used, the estimation process and the risks to which the entity is exposed would help their analyses. Accordingly, the disclosure requirements are designed to provide users of financial statements with such information.

BC22 The Board proposes to include the last sentence of paragraph A16 because the Board observed that some of the requirements in proposed paragraphs A17–A18 are similar to those in other IFRS Standards; an entity might already provide some of the information those proposed paragraphs require when applying other Standards. For example, an entity might already provide:

(a) summarised financial information about a foreign operation applying paragraphs B10 or B12–B13 of IFRS 12 *Disclosure of Interests in Other Entities*;

(b) information about the methodology used to estimate the spot exchange rate applying paragraphs 125–133 of IAS 1 *Presentation of Financial Statements*; and

(c) some (or all) of the qualitative and quantitative information about the nature and extent of risks arising from a currency that lacks exchangeability applying the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* and IFRS 12.

BC23 The Board concluded that it was unnecessary to include specific disclosure requirements regarding significant judgements made in assessing exchangeability. This is because paragraph 122 of IAS 1 would already require disclosure of such judgements to the extent they are part of the judgements management has made that have the most significant effect on the amounts recognised in the financial statements.

Transition

Entities already applying IFRS Standards

BC24 The Board developed the proposed transition requirements in paragraphs 60L–60M because it concluded that the expected benefits of requiring entities to apply the amendments retrospectively, applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Error*s, would not outweigh the costs. In particular:

(a) applying the amendments retrospectively would require an entity to assess exchangeability in prior periods and then estimate spot exchange rates for those prior periods. In many cases this would be likely to require the use of hindsight and, even if possible without hindsight, would be costly.

(b) a lack of exchangeability is generally accompanied by high inflation and other economic events that make trend information less useful for investors than in other situations. The Board was informed that, in these situations, users of financial statements are interested in understanding an entity's exposure at the reporting date to the currency that lacks exchangeability. The Board therefore concluded that an entity should apply the amendments from the date of initial application and not restate comparative information.

BC25 In developing the proposed transition requirements, the Board decided:

(a) to require an entity to translate items using the estimated spot exchange rate at the date of initial application if the related requirement in IAS 21 requires an entity to translate that item using the closing rate.

(b) not to permit an entity to retranslate other items, even though they may have been translated using a spot exchange rate that is not aligned with the proposed amendments. This is because the expected benefits of requiring an entity to identify those items and then estimate an appropriate exchange rate would not outweigh the cost.

(c) to require an entity to recognise any effect of initially applying the amendment as an adjustment to:

(i) the opening balance of retained earnings when the entity reports foreign currency transactions. For these transactions, an entity generally recognises exchange differences in profit or loss. Requiring entities to separately track any exchange differences recognised in other comprehensive income would introduce unnecessary complexity.

(ii) the cumulative amount of translation differences in equity when the entity uses a presentation currency other than its functional currency or translates the results and financial position of a foreign operation. In these situations, an entity generally recognises exchange differences in other comprehensive income and accumulates those differences in a separate component of equity.

First-time adopters

BC26 The Board concluded that a specific exemption from retrospective application of the amendments would be unnecessary for a first-time adopter because:

(a) 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.

(b) 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.

BC27 The requirements in IFRS 1 related to severe hyperinflation refer to, but do not define, exchangeability. The Board concluded that it should align the wording in IFRS 1 with the proposed amendments.

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