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## **Approval by the Board of IAS 21 issued in December 2003**

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International Accounting Standard 21 *The Effects of Changes in Foreign Exchange Rates* (as revised in 2003) was approved for issue by the fourteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Robert P Garnett	
Gilbert G�elard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
Harry K Schmid	
John T Smith	
Geoffrey Whittington	
Tatsumi Yamada	

## **Approval by the Board of *Net Investment in a Foreign Operation* (Amendment to IAS 21) issued in December 2005**

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*Net Investment in a Foreign Operation* (Amendment to IAS 21) was approved for issue by the fourteen members of the International Accounting Standards Board.

Sir David Tweedie	Chairman
Thomas E Jones	Vice-Chairman
Mary E Barth	
Hans-Georg Bruns	
Anthony T Cope	
Jan Engström	
Robert P Garnett	
Gilbert Gélard	
James J Leisenring	
Warren J McGregor	
Patricia L O'Malley	
John T Smith	
Geoffrey Whittington	
Tatsumi Yamada	

## **Approval by the IASB of *Lack of Exchangeability* issued in August 2023**

*Lack of Exchangeability*, which amended IAS 21 *The Effects of Changes in Foreign Exchange Rates*, was approved for issue by 12 of 14 members of the International Accounting Standards Board (IASB). Mr Esterer and Ms Keren abstained from voting in view of their recent appointment to the IASB.

Andreas Barckow

Chair

Linda Mezon-Hutter

Vice-Chair

Nick Anderson

Patrina Buchanan

Tadeu Cendon

Florian Esterer

Zach Gast

Hagit Keren

Jianqiao Lu

Bruce Mackenzie

Bertrand Perrin

Rika Suzuki

Ann Tarca

Robert Uhl

## Basis for Conclusions on IAS 21 *The Effects of Changes in Foreign Exchange Rates*

*This Basis for Conclusions accompanies, but is not part of, IAS 21.*

*Paragraph BC1 was amended and paragraphs BC25A–BC25F were added in relation to the amendment to IAS 21 issued in December 2005.*

*In this Basis for Conclusions the terminology has not been amended to reflect the changes made by IAS 1 Presentation of Financial Statements (as revised in 2007).*

### Introduction

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- BC1 This Basis for Conclusions summarises the International Accounting Standards Board’s considerations in reaching its conclusions on revising IAS 21 *The Effects of Changes in Foreign Exchange Rates* in 2003, and on the amendment to IAS 21 *Net Investment in a Foreign Operation* in December 2005. Individual Board members gave greater weight to some factors than to others.
- BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 21. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within Standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in an Exposure Draft of *Improvements to International Accounting Standards*, with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the Exposure Draft.
- BC3 Because the Board’s intention was not to reconsider the fundamental approach to accounting for the effects of changes in foreign exchange rates established by IAS 21, this Basis for Conclusions does not discuss requirements in IAS 21 that the Board has not reconsidered.

### Functional currency

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- BC4 The term ‘reporting currency’ was previously defined as ‘the currency used in presenting the financial statements’. This definition comprises two separate notions (which were identified in SIC-19 *Reporting Currency—Measurement and Presentation of Financial Statements under IAS 21 and IAS 29*):
- the measurement currency (the currency in which the entity measures the items in the financial statements); and
  - the presentation currency (the currency in which the entity presents its financial statements).
- The Board decided to revise the previous version of IAS 21 to incorporate the SIC-19 approach of separating these two notions. The Board also noted that the term ‘functional currency’ is more commonly used than ‘measurement currency’ and decided to adopt the more common term.
- BC5 The Board noted a concern that the guidance in SIC-19 on determining a measurement currency could permit entities to choose one of several currencies, or to select an inappropriate currency. In particular, some believed that SIC-19 placed too much emphasis on the currency in which transactions are denominated and too little emphasis on the underlying economy that determines the pricing of those transactions. To meet these concerns, the Board defined functional currency as ‘the currency of the primary economic environment in which the entity operates’. The Board also provided guidance on how to determine the functional currency (see paragraphs 9–14 of the Standard). This guidance draws heavily on SIC-19 and equivalent guidance in US and other national standards, but also reflects the Board’s decision that some factors merit greater emphasis than others.
- BC6 The Board also discussed whether a foreign operation that is integral to the reporting entity (as described in the previous version of IAS 21) could have a functional currency that is different from that of its ‘parent’.<sup>1</sup> The Board decided that the functional currencies will always be the same, because it would be contradictory

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<sup>1</sup> The term ‘parent’ is used broadly in this context to mean an entity that has a branch, associate or joint venture, as well as one with a subsidiary.

for an integral foreign operation that ‘carries on business as if it were an extension of the reporting enterprise’s operations’<sup>2</sup> to operate in a primary economic environment different from its parent.

- BC7 It follows that it is not necessary to translate the results and financial position of an integral foreign operation when incorporating them into the financial statements of the parent—they will already be measured in the parent’s functional currency. Furthermore, it is not necessary to distinguish between an integral foreign operation and a foreign entity. When a foreign operation’s functional currency is different from that of its parent, it is a foreign entity, and the translation method in paragraphs 38–49 of the Standard applies.
- BC8 The Board also decided that the principles in the previous version of IAS 21 for distinguishing an integral foreign operation from a foreign entity are relevant in determining an operation’s functional currency. Hence it incorporated these principles into the Standard in that context.
- BC9 The Board agreed that the indicators in paragraph 9 are the primary indicators for determining the functional currency and that paragraphs 10 and 11 are secondary. This is because the indicators in paragraphs 10 and 11 are not linked to the primary economic environment in which the entity operates but provide additional supporting evidence to determine an entity’s functional currency.

## Presentation currency

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- BC10 A further issue is whether an entity should be permitted to present its financial statements in a currency (or currencies) other than its functional currency. Some believe it should not. They believe that the functional currency, being the currency of the primary economic environment in which the entity operates, most usefully portrays the economic effect of transactions and events on the entity. For a group that comprises operations with a number of functional currencies, they believe that the consolidated financial statements should be presented in the functional currency that management uses when controlling and monitoring the performance and financial position of the group. They also believe that allowing an entity to present its financial statements in more than one currency may confuse, rather than help, users of those financial statements. Supporters of this view believe that any presentation in a currency other than that described above should be regarded as a ‘convenience translation’ that is outside the scope of IFRSs.
- BC11 Others believe that the choice of presentation currency should be limited, for example, to the functional currency of one of the substantive entities within a group. However, such a restriction might be easily overcome—an entity that wished to present its financial statements in a different currency might establish a substantive, but relatively small operation with that functional currency.
- BC12 Still others believe that, given the rising trend towards globalisation, entities should be permitted to present their financial statements in any currency. They note that most large groups do not have a single functional currency, but rather comprise operations with a number of functional currencies. For such entities, they believe it is not clear which currency should be the presentation currency, or why one currency is preferable to another. They also point out that management may not use a single currency when controlling and monitoring the performance and financial position of such a group. In addition, they note that in some jurisdictions, entities are required to present their financial statements in the local currency, even when this is not the functional currency.<sup>3</sup> Hence, if IFRSs required the financial statements to be presented in the functional currency, some entities would have to present two sets of financial statements: financial statements that comply with IFRSs presented in the functional currency and financial statements that comply with local regulations presented in a different currency.
- BC13 The Board was persuaded by the arguments in the previous paragraph. Accordingly, it decided that entities should be permitted to present their financial statements in any currency (or currencies).
- BC14 The Board also clarified that the Standard does not prohibit the entity from providing, as supplementary information, a ‘convenience translation’. Such a ‘convenience translation’ may display financial statements (or selected portions of financial statements) in a currency other than the presentation currency, as a convenience to some users. The ‘convenience translation’ may be prepared using a translation method other than that required by the Standard. These types of ‘convenience translations’ should be clearly identified as supplementary information to distinguish them from information required by IFRSs and translated in accordance with the Standard.

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<sup>2</sup> IAS 21 (revised 1993), paragraph 24

<sup>3</sup> This includes entities operating in another country and, for example, publishing financial statements to comply with a listing requirement of that country.

## Translation method

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- BC15 The Board debated which method should be used to translate financial statements from an entity's functional currency into a different presentation currency.
- BC16 The Board agreed that the translation method should not have the effect of substituting another currency for the functional currency. Put another way, presenting the financial statements in a different currency should not change the way in which the underlying items are measured. Rather, the translation method should merely express the underlying amounts, as measured in the functional currency, in a different currency.
- BC17 Given this, the Board considered two possible translation methods. The first is to translate all amounts (including comparatives) at the most recent closing rate. This method has several advantages: it is simple to apply; it does not generate any new gains and losses; and it does not change ratios such as return on assets. This method is supported by those who believe that the process of merely expressing amounts in a different currency should preserve the relationships among amounts as measured in the functional currency and, as such, should not lead to any new gains or losses.
- BC18 The second method considered by the Board is the one that the previous version of IAS 21 required for translating the financial statements of a foreign operation.<sup>4</sup> This method results in the same amounts in the presentation currency regardless of whether the financial statements of a foreign operation are:
- (a) first translated into the functional currency of another group entity (eg the parent) and then into the presentation currency, or
  - (b) translated directly into the presentation currency.
- BC19 This method avoids the need to decide the currency in which to express the financial statements of a multinational group before they are translated into the presentation currency. As noted above, many large groups do not have a single functional currency, but comprise operations with a number of functional currencies. For such entities it is not clear which functional currency should be chosen in which to express amounts before they are translated into the presentation currency, or why one currency is preferable to another. In addition, this method produces the same amounts in the presentation currency for a stand-alone entity as for an identical subsidiary of a parent whose functional currency is the presentation currency.
- BC20 The Board decided to require the second method, ie that the financial statements of any entity (whether a stand-alone entity, a parent or an operation within a group) whose functional currency differs from the presentation currency used by the reporting entity are translated using the method set out in paragraphs 38–49 of the Standard.
- BC21 With respect to translation of comparative amounts, the Board adopted the approach required by SIC-30 for:
- (a) an entity whose functional currency is not the currency of the hyperinflationary economy (assets and liabilities in the comparative balance sheet are translated at the closing rate at the date of that balance sheet and income and expenses in the comparative income statement are translated at exchange rates at the dates of the transactions); and
  - (b) an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into the currency of a hyperinflationary economy (both balance sheet and income statement items are translated at the closing rate of the most recent balance sheet presented).
- BC22 However, the Board decided not to adopt the SIC-30 approach for the translation of comparatives for an entity whose functional currency is the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into a presentation currency of a non-hyperinflationary economy. The Board noted that in such a case, the SIC-30 approach requires restating the comparative amounts from those shown in last year's financial statements for both the effects of inflation and for changes in exchange rates. If exchange rates fully reflect differing price levels between the two economies to which they relate, the SIC-30 approach will result in the same amounts for the comparatives as were reported as current year amounts in the prior year financial statements. Furthermore, the Board noted that in the prior year, the relevant amounts had been already expressed in the non-hyperinflationary presentation currency, and there was no reason to change them. For these reasons the Board decided to require that all comparative amounts are those presented in the prior year financial statements (ie there is no adjustment for either subsequent changes in the price level or subsequent changes in exchange rates).
- BC23 The Board decided to incorporate into the Standard most of the disclosure requirements of SIC-30 *Reporting Currency—Translation from Measurement Currency to Presentation Currency* that apply when a different

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<sup>4</sup> This is to translate balance sheet items at the closing rate and income and expense items at actual (or average) rates, except for an entity whose functional currency is that of a hyperinflationary economy.

translation method is used or other supplementary information, such as an extract from the full financial statements, is displayed in a currency other than the functional currency (see paragraph 57 of the Standard). These disclosures enable users to distinguish information prepared in accordance with IFRSs from information that may be useful to users but is not the subject of IFRSs, and also tell users how the latter information has been prepared.

## Capitalisation of exchange differences

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- BC24 The previous version of IAS 21 allowed a limited choice of accounting for exchange differences that arise ‘from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset’.<sup>5</sup> The benchmark treatment was to recognise such exchange differences in profit or loss. The allowed alternative was to recognise them as an asset.
- BC25 The Board noted that the allowed alternative (of recognition as an asset) was not in accordance with the *Framework for the Preparation and Presentation of Financial Statements*<sup>6</sup> because exchange losses do not meet the definition of an asset. Moreover, recognition of exchange losses as an asset is neither allowed nor required by any liaison standard-setter, so its deletion would improve convergence. Finally, in many cases when the conditions for recognition as an asset are met, the asset would be restated in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies*. Thus, to the extent that an exchange loss reflects hyperinflation, this effect is taken into account by IAS 29. For all of these reasons, the Board removed the allowed alternative treatment and the related SIC Interpretation is superseded.

## Net investment in a foreign operation

- BC25A The principle in paragraph 32 is that exchange differences arising on a monetary item that is, in substance, part of the reporting entity’s net investment in a foreign operation are initially recognised in a separate component of equity<sup>7</sup> in the consolidated financial statements of the reporting entity. Among the revisions to IAS 21 made in 2003 was the provision of guidance on this principle that required the monetary item to be denominated in the functional currency of either the reporting entity or the foreign operation. The previous version of IAS 21 did not include such guidance.
- BC25B The requirements can be illustrated by the following example. Parent P owns 100 per cent of Subsidiary S. Parent P has a functional currency of UK sterling. Subsidiary S has a functional currency of Mexican pesos. Parent P grants a loan of 100 US dollars to Subsidiary S, for which settlement is neither planned nor likely to occur in the foreseeable future. IAS 21 (as revised in 2003) requires the exchange differences arising on the loan to be recognised in profit or loss in the consolidated financial statements of Parent P, whereas those differences would be recognised initially in equity in the consolidated financial statements of Parent P, if the loan were to be denominated in sterling or Mexican pesos.
- BC25C After the revised IAS 21 was issued in 2003, constituents raised the following concerns:
- (a) It is common practice for a monetary item that forms part of an entity’s investment in a foreign operation to be denominated in a currency that is not the functional currency of either the reporting entity or the foreign operation. An example is a monetary item denominated in a currency that is more readily convertible than the local domestic currency of the foreign operation.
  - (b) An investment in a foreign operation denominated in a currency that is not the functional currency of the reporting entity or the foreign operation does not expose the group to a greater foreign currency exchange difference than arises when the investment is denominated in the functional currency of the reporting entity or the foreign operation. It simply results in exchange differences arising in the foreign operation’s individual financial statements and the reporting entity’s separate financial statements.
  - (c) It is not clear whether the term ‘reporting entity’ in paragraph 32 should be interpreted as the single entity or the group comprising a parent and all its subsidiaries. As a result, constituents questioned whether the monetary item must be transacted between the foreign operation and the reporting entity, or whether it could be transacted between the foreign operation and any member of the consolidated group, ie the reporting entity or any of its subsidiaries.

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<sup>5</sup> IAS 21 (revised 1993), paragraph 21.

<sup>6</sup> The reference is to the IASC’s *Framework for the Preparation and Presentation of Financial Statements*, adopted by the Board in 2001 and in effect when the Standard was revised.

<sup>7</sup> As a consequence of the revision of IAS 1 *Presentation of Financial Statements* in 2007 such differences are recognised in other comprehensive income.



- BC25D The Board noted that the nature of the monetary item referred to in paragraph 15 is similar to an equity investment in a foreign operation, ie settlement of the monetary item is neither planned nor likely to occur in the foreseeable future. Therefore, the principle in paragraph 32 to recognise exchange differences arising on a monetary item initially in a separate component of equity effectively results in the monetary item being accounted for in the same way as an equity investment in the foreign operation when consolidated financial statements are prepared. The Board concluded that the accounting treatment in the consolidated financial statements should not be dependent on the currency in which the monetary item is denominated, nor on which entity within the group conducts the transaction with the foreign operation.
- BC25E Accordingly, in 2005 the Board decided to amend IAS 21. The amendment requires exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation to be recognised initially in a separate component of equity in the consolidated financial statements. This requirement applies irrespective of the currency of the monetary item and of whether the monetary item results from a transaction with the reporting entity or any of its subsidiaries.
- BC25F The Board also proposed amending IAS 21 to clarify that an investment in a foreign operation made by an associate of the reporting entity is not part of the reporting entity's net investment in that foreign operation. Respondents to the exposure draft disagreed with this proposal. Many respondents said that the proposed amendment added a detailed rule that was not required because the principle in paragraph 15 was clear. In redeliberations, the Board agreed with those comments and decided not to proceed with that proposed amendment.

## Goodwill and fair value adjustments

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- BC26 The previous version of IAS 21 allowed a choice of translating goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity at (a) the closing rate or (b) the historical transaction rate.
- BC27 The Board agreed that, conceptually, the correct treatment depends on whether goodwill and fair value adjustments are part of:
- (a) the assets and liabilities of the acquired entity (which would imply translating them at the closing rate); or
  - (b) the assets and liabilities of the parent (which would imply translating them at the historical rate).
- BC28 The Board agreed that fair value adjustments clearly relate to the identifiable assets and liabilities of the acquired entity and should therefore be translated at the closing rate.
- BC29 Goodwill is more complex, partly because it is measured as a residual. In addition, the Board noted that difficult issues can arise when the acquired entity comprises businesses that have different functional currencies (eg if the acquired entity is a multinational group). The Board discussed how to assess any resulting goodwill for impairment and, in particular, whether the goodwill would need to be 'pushed down' to the level of each different functional currency or could be accounted for and assessed at a higher level.
- BC30 One view is that when the parent acquires a multinational operation comprising businesses with many different functional currencies, any goodwill may be treated as an asset of the parent/acquirer and tested for impairment at a consolidated level. Those who support this view believe that, in economic terms, the goodwill is an asset of the parent because it is part of the acquisition price paid by the parent. Thus, they believe, it would be incorrect to allocate the goodwill to the many acquired businesses and translate it into their various functional currencies. Rather, the goodwill, being treated as an asset of the parent, is not exposed to foreign currency risks, and translation differences associated with it should not be recognised. In addition, they believe that such goodwill should be tested for impairment at a consolidated level. Under this view, allocating or 'pushing down' the goodwill to a lower level, such as each different functional currency within the acquired foreign operation, would not serve any purpose.
- BC31 Others take a different view. They believe that the goodwill is part of the parent's net investment in the acquired entity. In their view, goodwill should be treated no differently from other assets of the acquired entity, in particular intangible assets, because a significant part of the goodwill is likely to comprise intangible assets that do not qualify for separate recognition. They also note that goodwill arises only because of the investment in the foreign entity and has no existence apart from that entity. Lastly, they point out that when the acquired entity comprises a number of businesses with different functional currencies, the cash flows that support the continued recognition of goodwill are generated in those different functional currencies.
- BC32 The Board was persuaded by the reasons set out in the preceding paragraph and decided that goodwill is treated as an asset of the foreign operation and translated at the closing rate. Consequently, goodwill should be allocated to the level of each functional currency of the acquired foreign operation. This means that the level to which goodwill is allocated for foreign currency translation purposes may be different from the level

at which the goodwill is tested for impairment. Entities follow the requirements in IAS 36 *Impairment of Assets* to determine the level at which goodwill is tested for impairment.

## Disposal or partial disposal of a foreign operation<sup>8</sup>

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BC33 In the second phase of the business combinations project the Board decided that the loss of control, significant influence or joint control of an entity is accounted for as a disposal for the purposes of IAS 21. Accordingly, a former parent accounts for the loss of control over a subsidiary as a disposal of the subsidiary, even if the former subsidiary becomes an associate or jointly controlled entity of the former parent. Similarly an investor accounts for the loss of significant influence over an associate or the loss of joint control over a jointly controlled entity<sup>9</sup> as a disposal. The Board decided that the change in the nature of the investment is a significant economic event.

BC34 The Board also decided in the second phase of the business combinations project that:

- (a) changes in the parent's ownership interest in a subsidiary that do not result in a loss of control are accounted for as equity transactions (ie transactions with owners in their capacity as owners);
- (b) if a parent loses control of a subsidiary, the parent reclassifies from equity to profit or loss (as a reclassification adjustment) the parent's share of the exchange differences recognised in other comprehensive income relating to a foreign operation in that subsidiary; and
- (c) if an investor loses significant influence over an associate or loses joint control over a jointly controlled entity, the investor reclassifies from equity to profit or loss (as a reclassification adjustment) the exchange differences recognised in other comprehensive income relating to a foreign operation in that associate or jointly controlled entity.

The amendments in paragraphs 48A–49 of the Standard reflect those decisions for the disposal or partial disposal of a foreign operation.

BC35 As part of *Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate* (Amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* and IAS 27 *Consolidated and Separate Financial Statements*), issued in May 2008, the Board amended IAS 27 to remove the definition of the 'cost method'. The cost method required an entity to recognise distributions as income only if they came from post-acquisition retained earnings. Distributions received in excess of such profits were regarded as a recovery of the investment and were recognised as a reduction of its cost. Consequently, the Board amended paragraph 49 to remove the reference to pre-acquisition profits and to clarify that a dividend accounted for in accordance with paragraph 38A of IAS 27 cannot be a disposal or partial disposal of a net investment in IAS 21.<sup>10</sup>

## Disposal or partial disposal of a foreign operation (amendment 2011)

BC36 During its redeliberation of the exposure draft ED 9 *Joint Arrangements*, the Board reconsidered whether its decision in the second phase of the business combinations project to characterise loss of joint control or loss of significant influence as a significant economic event (ie in the same way that loss of control is characterised as a significant economic event) was appropriate. If it were, the Board thought that the entity should be required to recalibrate the accounting as required by IFRS 10 *Consolidated Financial Statements*. However, the Board concluded that, although significant, the events are fundamentally different. In the case of loss of control, the cessation of the parent-subsidiary relationship results in the derecognition of assets and liabilities because the composition of the group changes. If joint control or significant influence is lost the composition of the group is unaffected.

BC37 The Board also noted that retaining the characterisation of significant economic event in the case of loss of joint control or significant influence when the retained interest is a financial asset is unnecessary. IFRS 9 already requires that in such cases the retained interest (ie a financial asset) must be measured at fair value.

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<sup>8</sup> This heading and paragraphs BC33 and BC34 were added as a consequence of amendments to IAS 27 *Consolidated and Separate Financial Statements* made as part of the second phase of the business combinations project in 2008. The consolidation requirements in IAS 27 were superseded by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements did not change.

<sup>9</sup> 'Jointly controlled entities' were defined in IAS 31 *Interests in Joint Ventures*. IFRS 11 *Joint Arrangements*, issued in May 2011, replaced IAS 31 and changed terminology.

<sup>10</sup> The consolidation guidance was removed from IAS 27 and the Standard was renamed *Separate Financial Statements* by IFRS 10 *Consolidated Financial Statements* issued in May 2011. The accounting requirements for dividends were not changed.

- BC38 In the case of loss of joint control when significant influence is maintained, the Board acknowledged that the investor- investee relationship changes and, consequently, so does the nature of the investment. However, in this instance, both investments (ie the joint venture and the associate) continue to be measured using the equity method. Considering that there is neither a change in the group boundaries nor a change in the measurement requirements, the Board concluded that losing joint control and retaining significant influence is not an event that warrants remeasurement of the retained interest at fair value.
- BC39 Consequently, the Board removed all descriptions that characterise loss of joint control or significant influence as a significant economic event as introduced in the second phase of the Board's project on business combinations.
- BC40 The Board also decided to align the conclusions reached on the loss of joint control when significant influence is maintained with the requirements in IAS 21 so that the change from joint control to significant influence is treated as a 'partial' disposal rather than deemed to be an 'entire' disposal. As a consequence, the Board concluded that when an entity loses joint control of a joint arrangement that includes a foreign operation but retains significant influence, an entity reclassifies to profit or loss only the proportionate share of the cumulative amount of the exchange differences recognised in other comprehensive income relating to a foreign operation in that joint arrangement.

## Lack of Exchangeability

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### Background to the August 2023 amendments

- BC41 In August 2023 the IASB issued *Lack of Exchangeability* and amended the Standard to improve the usefulness of information provided to users of financial statements. The amendments require 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. The IASB had been informed of diverse views among stakeholders 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 into another currency might arise relatively infrequently, when they do arise, economic conditions can deteriorate rapidly. In those circumstances, the diverse views on the application of the Standard could have led to material differences in affected entities' financial statements. In developing the amendments, the IASB considered input from the IFRS Interpretations Committee and feedback from stakeholders on the IASB's April 2021 Exposure Draft *Lack of Exchangeability*.

### Assessing whether a currency is exchangeable

- BC42 Many factors influence the exchangeability of one currency into another currency. To make the definition of 'exchangeable' operational and to help entities apply that definition consistently, the Standard specifies when an entity is able to exchange a currency for another currency. In developing the definition and related application guidance, the IASB discussed the following questions:
- (a) what time frame for obtaining the other currency does an entity consider (see paragraphs BC43–BC44)?
  - (b) what if an entity is able to obtain the other currency, but does not intend to do so (see paragraph BC45)?
  - (c) which markets or exchange mechanisms for obtaining the other currency does an entity consider (see paragraph BC46)?
  - (d) what is the purpose for which an entity obtains the other currency (see paragraphs BC47–BC50)?
  - (e) what if an entity is able to obtain only limited amounts of the other currency (see paragraphs BC51–BC52)?

### Time frame

- BC43 The IASB concluded that a normal administrative delay in obtaining the other currency:
- (a) does not contradict the notion of 'immediate delivery' in the definition of a spot exchange rate in paragraph 8 of the Standard. In the IASB's view, the notion of 'immediate delivery' incorporates a short period of time to meet administrative, legal or regulatory requirements in exchanging currencies.

- (b) does not preclude a currency from being exchangeable into that other currency. In the IASB's view, acknowledging the existence of normal administrative delays in currency exchanges improves the operability of the requirements. If an entity cannot consider a normal administrative delay in its assessment of the time frame to exchange one currency for another, the entity might inappropriately conclude that a currency is not exchangeable into another currency.

BC44 The IASB decided not to develop application guidance on what constitutes a 'normal administrative delay'—this assessment would depend on facts and circumstances.

### **Ability to obtain the other currency**

BC45 The IASB decided that assessing whether a currency is exchangeable into another currency depends on an entity's ability to obtain the other currency and not on 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 requirement is consistent with other requirements in the Standard—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**

BC46 The IASB observed that the nature and type of markets or exchange mechanisms can vary between jurisdictions. The IASB discussed whether to require an entity to consider specified markets or exchange mechanisms (for example, government-administered exchange mechanisms) when assessing exchangeability. The IASB decided that, when assessing whether a currency is exchangeable into another currency, entities consider only markets or exchange mechanisms in which a transaction to exchange that currency into the other currency would create enforceable rights and obligations.

### **Purpose of obtaining the other currency**

BC47 In many jurisdictions (particularly those in which exchange rates are free-floating), only one exchange rate exists between two currencies. In such jurisdictions, 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 might apply for different uses, which could affect an entity's ability to obtain those currencies. The IASB therefore concluded that it is important for an entity to consider the purpose for which it obtains the other currency.

BC48 The IASB considered, separately, situations in which an entity:

- (a) reports foreign currency transactions in its functional currency (see paragraph BC49); and  
 (b) uses a presentation currency other than its functional currency or translates the results and financial position of a foreign operation (see paragraph BC50).

BC49 Paragraphs 20–37 of the Standard specify requirements for reporting foreign currency transactions in the functional currency. These requirements apply to individual foreign currency transactions, and monetary and non-monetary items relating to such transactions. The IASB decided that, when reporting foreign currency transactions, an entity assesses 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 realise or settle the individual foreign currency transaction, or an asset or liability related to that transaction. An entity would therefore assess whether it is able to obtain the other currency to realise or settle the transaction, or the asset or liability related to that transaction. Requiring entities to assess each individual transaction, asset or liability does not create a new assessment, because paragraph 26 of the Standard requires an entity to do so when several exchange rates are available.

BC50 Paragraphs 38–49 of the Standard 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. These requirements apply to all assets and liabilities (that is, the net assets or net liabilities)—and not to individual assets or liabilities—of an entity or its foreign operation. The IASB therefore decided that, in these situations, an entity assesses exchangeability from the perspective of a transaction that would result in realising or settling its net assets or net liabilities (or net investment in the foreign operation). The IASB observed that:

- (a) entities in some jurisdictions might experience a delay in remitting dividends, and such a delay would not necessarily result in an entity concluding that a currency is not exchangeable into the other currency; such a delay might reflect a normal administrative delay. Also, an entity concluding that a currency is not exchangeable into another currency does not automatically require the entity to use a complex estimation technique (see paragraph BC55).

- (b) an entity considers its ability to realise its net assets (or net investment in a foreign operation) in a single transaction—and not over time—even though an entity might often be unable to realise its net assets in a single transaction. This consideration is consistent with other requirements in the Standard (see paragraph BC49). In accordance with paragraph A10 of the Standard, 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 (see paragraphs BC51–BC52).

### **Ability to obtain only limited amounts of the other currency**

- BC51 An entity might be able to obtain only limited amounts of the other currency. The IASB decided to specify that, in such circumstances, a currency is exchangeable into another currency when an entity is able to obtain more than an insignificant amount of that other currency. This approach 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 (see paragraphs B37–B42 of IFRS 13), in which case an entity may depart from using unadjusted observable prices. Similarly, when the activity in the market in which an entity obtains the other currency is so low that the entity is able to obtain no more than an insignificant amount of that other currency, the entity estimates the spot exchange rate applying paragraph 19A of the Standard—in which case the entity may depart from using the observable exchange rate.
- BC52 In developing the requirements, the IASB considered the level at which an entity assesses the significance of the amount of the other currency it is able to obtain—for example, whether an entity performs this assessment for each transaction and balance separately, or on an aggregated basis. The IASB decided that an entity assesses the significance of the amount of the other currency it is able to obtain for a specified purpose using the aggregate method described in paragraph A10 of the Standard. Instead of requiring an entity to consider each transaction or balance separately, the aggregate method requires an entity to compare the amount of the other currency it is able to obtain with the aggregated amount (the sum) of the transactions or balances it needs to recover or settle.

### **Estimating the spot exchange rate when a currency is not exchangeable**

- BC53 The IASB decided that when one currency is not exchangeable into another currency at a measurement date, an entity estimates the spot exchange rate at that date. The objective in paragraph 19A of the Standard is for an entity to estimate the rate at which an orderly exchange transaction hypothetically would take place at the measurement date between market participants under prevailing economic conditions. This approach is similar to (although not the same as) an entity measuring an asset or liability at fair value by estimating the price at which an orderly transaction to sell the asset or transfer the liability hypothetically would take place at the measurement date.
- BC54 The IASB decided not to provide any detailed requirements on how an entity estimates a spot exchange rate because:
- (a) estimating a spot exchange rate can be complicated and depends on entity-specific and jurisdiction-specific facts and circumstances.
  - (b) the economic models an entity might use to estimate a spot exchange rate are varied. These 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). The IASB decided not to prescribe one particular estimation technique or approach because that technique or approach would be unlikely to capture all relevant factors for all possible situations without being overly 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. An entity is required to disclose relevant information about the estimated spot exchange rate and the estimation technique (see paragraphs BC58–BC62).
  - (e) such an approach is consistent with the measurement requirements in other IFRS Accounting Standards. For example, IFRS 9 *Financial Instruments* does not specify a particular technique for the measurement of expected credit losses, but instead sets out an objective.
- BC55 The IASB noted that when a currency is not exchangeable into another currency, an entity would not necessarily need to use a complex estimation technique. To reduce complexity, the IASB decided to:

- (a) specify that an entity may use an observable exchange rate without adjustment as the estimated spot exchange rate, if that observable exchange rate meets the objective in paragraph 19A of the Standard (see paragraph A12 of the Standard).
- (b) include two examples of observable exchange rates that an entity could consider and set out a non-exhaustive list of factors to help entities assess whether those observable exchange rates would meet the objective in paragraph 19A of the Standard (see paragraphs A13–A16 of the Standard).
- (c) specify that an entity using another estimation technique could, for example, start with an observable exchange rate—including a rate from an exchange transaction in a market or exchange mechanism that does not create enforceable rights and obligations—and adjust that rate, as necessary, to estimate the spot exchange rate as required by paragraph 19A of the Standard (see paragraph A17 of the Standard).

### Other considerations

- BC56 The IASB decided not to specify a hierarchy of observable exchange rates to use in estimating a spot exchange rate because doing so might impose costs without providing more useful information. For example, a hierarchy of observable exchange rates would require an entity to look for, and successively consider, each exchange rate in the hierarchy, when it might be more cost-effective for the entity to use another estimation technique.
- BC57 When an entity is able to obtain only limited amounts of the other currency, the IASB considered whether to permit or require the entity 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 IASB decided not to permit or require the use of such a rate because:
- (a) determining a blended exchange rate could be difficult for an entity, 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 paragraph A10 of the Standard, the entity would conclude that a currency is not exchangeable into the other currency only when the entity is able to obtain no more than an insignificant amount of the other currency. Therefore, in most cases, the IASB expected that a blended exchange rate will not differ significantly from the estimated spot exchange rate.

### Disclosure

- BC58 An entity's estimation of a spot exchange rate when a currency is not exchangeable into another currency could materially affect its financial statements. That estimation would also require the entity to make judgements and assumptions. In developing the requirements, the IASB was informed that users of financial statements are interested not only in the effect on an entity's financial statements of estimating the spot exchange rate, but also in understanding an entity's exposure to a currency that is not exchangeable into another currency. Users said information about the nature and financial effects of a currency not being exchangeable into another currency, the spot exchange rate used, the estimation process and the risks to which the entity is exposed would help their analyses. Accordingly, the applicable disclosure requirements in the Standard are designed to provide users with such information.
- BC59 The IASB observed that some of the requirements in paragraphs A19–A20 of the Standard are similar to those in other IFRS Accounting Standards. An entity might already provide some of the information those paragraphs require when applying other Standards. For example, an entity might already provide:
- (a) summarised financial information about a foreign operation, in accordance with 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, in accordance with 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 is not exchangeable into another currency, in accordance with the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* and IFRS 12.
- BC60 Nonetheless, the IASB concluded it would be helpful to include the requirements in paragraphs A19–A20 of the Standard. The IASB observed that an entity need not duplicate information required by the Standard if it has provided the information in its financial statements by applying other disclosure requirements.

- BC61 The IASB concluded that it was unnecessary to include specific disclosure requirements regarding significant judgements made in assessing exchangeability. Paragraph 122 of IAS 1 already requires disclosure of such judgements to the extent they are part of the judgements an entity's management has made that have the most significant effect on the amounts recognised in the financial statements.
- BC62 The IASB noted that, for an entity applying paragraph 57A of the Standard, disclosures are required when a currency is not exchangeable into another currency at the end of the reporting period and also when a currency is not exchangeable into another currency during part of the reporting period—even if that is no longer the case at the end of the reporting period.

## Transition

### Entities already applying IFRS Accounting Standards

- BC63 The IASB developed the transition requirements in paragraphs 60L–60M of the Standard because it concluded that the expected benefits of requiring entities to apply the amendments retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, 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, retrospective application would be likely to require the use of hindsight and, even if possible without hindsight, would be costly.
  - (b) a currency not being exchangeable into another currency is generally accompanied by high inflation and other economic events that make trend information less useful for investors than in other situations. The IASB was informed that, when a currency is not exchangeable into another currency, users of financial statements are interested in understanding an entity's exposure at the reporting date to that currency. The IASB therefore concluded that an entity applies the amendments from the date of initial application without restating comparative information.
- BC64 The IASB 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 the Standard requires an entity to translate that item using the closing rate.
  - (b) not to permit an entity to retranslate other items, even though they might have been translated using a spot exchange rate that is not aligned with the amendments. The expected benefits of requiring an entity to identify those items and then estimate an appropriate exchange rate would not outweigh the costs.
  - (c) to require an entity to recognise any effect of initially applying the amendments 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 track separately 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

- BC65 The IASB 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 IFRS Accounting Standards.

## Illustrative Examples accompanying IAS 21 *The Effects of Changes in Foreign Exchange Rates*

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*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

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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 might be present in actual fact patterns, fact patterns in the examples are simplified, and an entity would need to evaluate all relevant facts and circumstances when applying IAS 21. The examples do not illustrate all the requirements in IAS 21, nor do they create additional requirements.

### Exchangeability

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IE2 Examples 1–3 illustrate how an entity assesses whether a currency is exchangeable (Step I as set out in paragraphs 8, 8A–8B and A2–A10). Examples 4–5 illustrate how an entity estimates the spot exchange rate when a currency is not exchangeable (Step II as set out in paragraphs 19A and A11–A17). In all five examples:

- (a) Entity X’s functional and presentation currency is 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 authority administers the exchangeability of LC for other currencies.

#### Step I: Assessing whether a currency is exchangeable (paragraphs 8, 8A–8B and A2–A10)

##### Example 1—Time frame

IE3 The relevant authority in Entity Y’s jurisdiction makes PC available to entities in exchange for LC only after completion of an administrative process. The authority requires entities wishing to obtain PC to explain how they intend to use PC when submitting a request for PC. In usual circumstances, an entity obtains PC after N days—that is, N days is the time the authority needs, under its administrative process, to perform checks and provide PC.

IE4 Entity X considers N days to be a normal administrative delay applying to a transaction to exchange LC for PC through this exchange mechanism. Subject to the other requirements in paragraphs A2–A10, Entity X considers LC to be exchangeable into PC if Entity X is able to obtain PC within N days of requesting it.

##### Example 2—Markets or exchange mechanisms

IE5 The relevant 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 that is not set by the authority. These exchange transactions 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 relevant 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 assesses 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: Estimating the spot exchange rate when a currency is not exchangeable (paragraphs 19A and A11–A16)**

### **Example 4—Using an observable exchange rate for another purpose (paragraphs A11–A14)**

#### *Fact pattern*

- IE9 At 31 December 20X1 the relevant authority in Entity Y's jurisdiction prevents entities from obtaining PC for the purpose of realising 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 At the measurement date of 31 December 20X1 Entity X is unable to obtain PC to realise its net investment in Entity Y. Therefore, Entity X concludes that LC is not exchangeable into PC.

#### *Estimating the spot exchange rate*

- IE11 Because Entity X concludes that LC is not exchangeable into PC, Entity X is required to estimate the spot exchange rate that meets the objective in paragraph 19A.
- IE12 Applying paragraphs A11–A14, Entity X considers whether it might use the observable LC:PC exchange rate for the purpose of realising a net investment in an entity. To do so, it assesses whether that observable exchange rate meets the objective in paragraph 19A and 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.
- IE13 Considering these factors, Entity X determines that the observable LC:PC exchange rate meets the objective in paragraph 19A. Therefore, Entity X may use that observable exchange rate as the estimated spot exchange rate when it translates the results and financial position of Entity Y.

### **Example 5—Using the first subsequent exchange rate (paragraphs A11–A12 and A15–A16)**

#### *Fact pattern*

- IE14 At 31 December 20X1 the jurisdiction in which Entity Y operates is subject to hyperinflation. The relevant authority in Entity Y's jurisdiction prevents entities from obtaining PC for the purpose of realising a net investment in an entity operating in that jurisdiction. However, from 30 April 20X2, the authority allows entities to obtain PC for that purpose.
- IE15 At the measurement date of 31 December 20X1 Entity X is unable to obtain PC to realise its net investment in Entity Y. Therefore, Entity X concludes that LC is not exchangeable into PC.

#### *Estimating the spot exchange rate*

- IE16 Because Entity X concludes that LC is not exchangeable into PC, Entity X is required to estimate the spot exchange rate that meets the objective in paragraph 19A.

- IE17 Applying paragraphs A11–A12 and A15–A16, Entity X considers whether it might use the first exchange rate at which it is able to obtain the other currency after exchangeability of the currency is restored (first subsequent exchange rate). To do so, it assesses whether that first subsequent exchange rate meets the objective in paragraph 19A and considers:
- (a) *the time between the measurement date and the date at which exchangeability is restored*—exchangeability is restored four months after the measurement date.
  - (b) *inflation rate*—the jurisdiction in which Entity Y operates is subject to hyperinflation.
- IE18 Considering these factors, Entity X determines that the first subsequent exchange rate does not reflect the prevailing economic conditions at the measurement date. Therefore, the first subsequent exchange rate does not meet the objective in paragraph 19A for the purpose of realising Entity X's net investment in Entity Y. However, Entity X could adjust that rate, as necessary, to estimate a rate that meets the objective in paragraph 19A for realising its net investment in Entity Y.