EFRAG
European Financial Reporting Advisory Group

Draft Comment Letter

You can submit your comments on EFRAG's draft comment letter by using the '[Express your views](#)' page on EFRAG's website, then open the relevant news item and click on the 'Comment publication' link at the end of the news item.

Comments should be submitted by 26 August 2021.

International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[xx Month 2021]

Dear Mr Barckow,

Re: Exposure Draft ED/2021/4 *Lack of Exchangeability*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft ED/2021/4 *Lack of Exchangeability*, proposed amendments to IAS 21, issued by the IASB on 20 April 2021 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

In principle, EFRAG agrees with the IASB's proposals to amend IAS 21 *The Effects of Changes in Foreign Exchange Rates* to address the issue of insufficient guidance applicable to the situations where a currency lacks exchangeability. EFRAG considers that the proposals would lead to a reduction of divergency in practice, and an increase in transparency what method is applied. However, EFRAG raises several requests to clarify the proposals in order to better align the proposals with the existing guidance.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Sebastian Weller, Robert Stojek, or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Notes to constituents – Assessing exchangeability between two currencies (Question 1)

1 *The IASB proposes that when, at measurement date, exchangeability between two currencies is lacking, an entity should estimate the spot exchange rate at that date to translate currencies. The ED proposes that a currency is not lacking exchangeability when an entity:*

a) *is able to exchange more than an insignificant amount of that currency for the other currency within a timeframe that includes a normal administrative delay,*

b) *through a market or exchange mechanism in which the exchange transaction would create enforceable rights and obligations.*

c) *In assessing whether a currency is exchangeable into another currency, an entity shall consider its ability to obtain the other currency, either directly (exchange of currency A to currency B) or indirectly (exchange of currency A to currency C and exchange of currency C to currency B).*

2 *Paragraph A9 of the ED states that whether a currency is exchangeable into another currency could also depend on the purpose for which the entity obtains the other currency. Therefore, the ED proposes that the above assessment (paragraphs A2 – A11 of the ED) should be made separately for each of the following purposes of obtaining other currency (or reporting purposes):*

a) *settling individual foreign currency transactions, assets or liabilities for foreign currency transactions reported in the entity's functional currency.*

b) *realising the entity's net assets for the use of a presentation currency other than the entity's functional currency.*

c) *realising the entity's net investment in a foreign operation for translating the results and financial position of that foreign operation.*

3 *The ED also proposes that, in cases where the entity is able to obtain no more than an insignificant amount of the other currency, a currency is not exchangeable into the other currency. The assessment of the significance of amount of other currency the entity is able to obtain for a specified purpose, should be done by comparing that amount with the total amount of the other currency (aggregate method according to paragraph BC16 of the ED) required for that purpose.*

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.

EFRAG's response

EFRAG agrees with the proposed amendments regarding the assessment of lack of exchangeability. In particular, EFRAG agrees with the proposed guidance on the assessment of time frame, the sole focus on the entity´s ability to obtain the other currency, without considering the intent to do so, and the decision 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.

EFRAG agrees that, when assessing exchangeability of a currency, it is important for an entity to separately consider the purpose for which it obtains this currency.

However, EFRAG proposes the IASB to clarify the relationship between the notion 'normal administrative delay' and the definition of the spot exchange rate provided in paragraph 8 of IAS 21, to explain that `normal administrative delay` does not prevent the immediate fixing of the exchange rate as required by the definition.

EFRAG also proposes to add context to Example 2 in the Illustrative Examples part of ED to explain the reasons for the result of assessment of lack of enforceable rights and obligations.

4 EFRAG generally agrees with the proposal of the IASB that provides preparers with guidance regarding the definition and the assessment of a lack of exchangeability that is not temporary. IAS 21 in its current state does not provide such guidance, therefore the amendment, through addressing the issue of insufficient guidance applicable to situations where a currency lacks exchangeability, would add to clarity of the guidance of IFRS Standards, and increase transparency of what estimation method is used in such situations. Consequently, the amendment is expected to reduce diversity in practice.

5 EFRAG agrees also with the IASB`s proposed definition of the time frame and the conclusion of the IASB that ignoring normal administrative delays would lead to entities inappropriately concluding that exchangeability is lacking when a currency would, in effect, be exchangeable into that other currency. Otherwise, the proposed guidance would be too restrictive.

6 EFRAG agrees that what constitutes a normal administrative delay, depends on facts and circumstances. Therefore, in EFRAG view it is appropriate that the ED does not propose detailed application guidance on what would constitute a ´normal administrative delay` in detail.

7 EFRAG notes that paragraph 8 of IAS 21, provides a definition of spot exchange rate. In accordance with this definition a rate would satisfy the condition of spot exchange rate only if the delivery is immediate. Consequently, the ED should elaborate on the fact that the notion of 'normal administrative delay' does not

contradict the definition of a spot exchange rate set out in IAS 21 and that 'normal administrative delay' does not refer to the time required for fixing the exchange rate.

8 In assessing whether a currency is exchangeable into another currency, an entity shall consider its ability to obtain the other currency - either directly or indirectly (i.e., using an intermediary currency). This condition reflects the IASB`s view that only the ability, but not the intention or decision to do so, is relevant for the assessment of a lack of exchangeability. EFRAG supports the IASB`s view as the intention to exchange currency could potentially extend the scope of the amendment, where – in effect – no lack of exchangeability exists.

9 EFRAG agrees with the IASB`s proposal that the entity`s assessment 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. The IASB 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. However, EFRAG suggests adding context to Example 2 in the Illustrative Examples part of the ED as the example does not provide reasons for the lack of enforceability of rights/obligations in the described jurisdiction. EFRAG also agrees that the ED proposes that enforceability is a matter of law and that whether enforceable rights and obligations arise depends on facts and circumstances.

10 EFRAG agrees that it is important for an entity to consider the purpose for which it obtains the other currency when assessing exchangeability for each reporting purpose separately, as for some currencies different exchange rates apply for different uses affecting an entity's ability to obtain those currencies. In the IASB´s view in many jurisdictions only one exchange rate exists between two currencies. Thus, 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, EFRAG agrees with the IASB conclusion that it is important for an entity to consider the purpose for which it obtains the other currency when assessing exchangeability, as for some currencies different exchange rates apply for different uses affecting an entity's ability to obtain those currencies.

11 EFRAG also notes that the proposed approach on the separate assessment for each reporting purpose aligns with:

a) the current guidance in paragraphs 20 – 37 of IAS 21 for reporting foreign currency transaction in the functional currency and

b) paragraphs 38 – 49 of IAS 21 for use of a presentation currency other than the functional currency and for translating the results and financial position of a foreign operation.

12 Finally, the ED proposes that a lack of exchangeability exists when the entity is able to obtain 'no more than an insignificant amount' of the other currency. EFRAG agrees with the IASB`s view that the entity should assess significance by comparing the amount, that could be obtained, with the total amount of the other currency required (aggregate approach). EFRAG agrees with the IASB`s rationale in this respect because this notion:

a) would align more closely with the IASB's view that an entity should estimate the spot exchange rate only in a narrow set of circumstances and

b) would be more similar to the approach used in IFRS 13 *Fair Value Measurement* when the volume or level of activity for an asset or liability has significantly decreased (depart from using observable prices/spot exchange rates).

Notes to constituents – Determining the spot exchange rate when exchangeability is lacking (Question 2)

13 *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. A currency that is not exchangeable into another currency has no observable spot exchange rate.*

14 *Thus, the ED proposes to specify how to determine the spot exchange rate in those circumstances based on conditions to be met. The ED does not propose detailed requirements on how an entity should make that estimate or prescribe an estimation technique.*

15 *In accordance with the proposed guidance (paragraph 19A of the ED) the estimated spot exchange rate shall meet all of 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.*

16 *Paragraph 19B of the ED states that the entity may use an observable exchange rate as the estimated spot exchange rate when that observable exchange rate meets also one of the following conditions:*

- *(a) It is a spot exchange rate for a purpose other than that for which the entity assesses exchangeability; or*
- *(b) It is the first exchange rate at which an entity is able to obtain the other currency after exchangeability of the currency is restored.*

17 *In assessing whether the observable exchange rate for a purpose other than that for which the entity assesses exchangeability meets the conditions in paragraph 19A of the ED, the ED proposes that an entity shall also consider, among other factors:*

- a) *whether several exchange rates exist – those 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 - the entity is able to obtain the other currency only for limited purposes, indicating that 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.*
- 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.*

18 *In assessing whether the first subsequent exchange rate at which an entity is able to obtain the other currency meets the conditions in paragraph 19A of the ED, the ED proposes that an entity shall also 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 (IAS 29) or is otherwise subject to high inflation, prices often change quickly and might change several times a day. The first subsequent exchange rate for a currency of such an economy may not faithfully reflect the prevailing economic conditions.*

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.

EFRAG's response

EFRAG agrees with the proposed approach on how to determine the spot exchange rate when exchangeability is lacking. EFRAG also agrees with the proposed guidance to use a principles-based approach to estimate spot exchange rates by setting up conditions that an exchange rate must fulfil.

However, EFRAG suggests improving application guidance on the assessment explained in paragraph A13 of the ED and the possible consequences for adjusting the exchange rate. In this context, EFRAG suggests addressing the use of observable exchange rates reached in unofficial or illegal currency exchange transactions.

19 EFRAG agrees with the proposed approach on how to determine the spot exchange rate when exchangeability is lacking. EFRAG supports the conclusion that establishing conditions to support the estimation process is more appropriate then prescribing detailed rules. EFRAG supports the IASB`s view that a detailed description of a proposed model would be too burdensome. Moreover, EFRAG is aware that other IFRS Standards do not prescribe certain estimation techniques in detail as well (e.g., measurement of expected credit losses under IFRS 9).

20 EFRAG agrees with the IASB`s view that an entity would not necessarily need to use a complex estimation technique as in some situations an entity could simply estimate the spot exchange rate by adjusting an observable exchange rate in accordance with paragraph 19A of the ED. EFRAG also agrees with the IASB that the guidance should not propose any detailed requirements on estimation of a spot exchange rate. Therefore, in this respect, EFRAG does not suggest changing the guidance as described by the ED.

21 Nevertheless, EFRAG suggests adding a comprehensive illustrative example or other explanatory content in the Basis for Conclusions as an example of an estimation procedure. In EFRAG's opinion, an additional example would help the preparers to better understand how to apply the required adjustments. In EFRAG's view more explanatory content would contribute to understandability and would simplify application and therefore result in less diversity in practice.

22 In EFRAG`s view, the IASB should also improve the guidance related to the assessment of the conditions to determine whether an entity may use an observable exchange rate as an estimated spot exchange rate and, when the conditions are not met, the effect of the assessment on the estimation of spot exchange rate. For instance, if the assessment in paragraph A13 of IAS 21 would lead to a conclusion that the observable exchange rate would not faithfully reflect the prevailing

economic conditions (i.e., exchange rate would not be free floating) the guidance should explain:

a) whether this fact should be reflected in the estimation process, and

b) how this fact should be reflected;

c) Nevertheless, as stated before, EFRAG would not suggest prescribing a certain calculation method.

23 Furthermore, EFRAG suggests the IASB to consider requiring the use of observable rates, when the conditions in paragraph 19A of the ED are met, instead of just permitting to use them. This would streamline the process of applying the proposed guidance and consequently reduce the application cost and reduce possible divergence in practice.

24 Finally, EFRAG suggests the IASB to explicitly address the use of observable but not official rates[1], as well as the practice to use of illegal rates (so called "black-market" rates) , which may be found applied in in some jurisdictions.

Question to Constituents

25 In your view, at the measurement date, if an observable exchange rate that applies for a purpose other than the purpose for which the entity assesses exchangeability, meets the conditions in paragraph 19A of the ED, should the use of this observable exchange rate be required rather than permitted?

26 What methods do you currently use to adjust exchange rates that lack exchangeability? Which factors do the models consider (inflation, penalties, incentives etc.)?

27 Do you think that changing the functional currency of the foreign operation would be a potential solution to avoid the exchangeability problem?

28 In your view, would you consider additional guidance regarding the estimation process, when the observed rate does not faithfully reflect the prevailing economic conditions, as useful? What kind of additional information would you consider as useful?

Notes to constituents – Disclosures (Question 3)

29 Paragraph 57A of the ED proposes that, when estimating a spot exchange rate, the entity should 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 (disclosure objective).

30 To achieve this objective, an entity shall disclose the following information:

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.*

[1] In the economic reality of some jurisdictions, unofficial, or illegal/black, markets exist. On such markets, the transactions do not create enforceable rights and obligations. Nevertheless, the floating prices may be observed and even followed in practice, as input in the process of estimating the spot exchange rates.

31 *An entity shall consider the detail necessary to satisfy the disclosure objective in paragraph 57A of the ED, therefore the following additional information shall be disclosed and also all additional information that would be required to meet the ED`s disclosure objective (item of information):*

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 and the carrying amount of affected assets and liabilities;*

c) *the spot exchange rates used and whether those rates are observable or determined using an estimation technique;*

d) *a description of any estimation technique used and information (qualitative and quantitative) on inputs used.*

e) *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.*

32 *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.*

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.

EFRAG's response

EFRAG agrees with the proposed disclosure objective and the disclosure requirements as proposed in the ED. EFRAG is of the view that these disclosure requirements will provide relevant information to users of financial statements to understand the effects of estimating the spot exchange rate on the financial statements and the entity`s exposure to a currency that lacks exchangeability.

EFRAG supports the ED`s proposal that the required disclosures need not be duplicated in cases where the entity has provided the information elsewhere in its financial statements.

EFRAG suggests including an additional disclosure requirement about situations where entities are not able to access foreign capital resources on a non-temporary basis (locked in capital).

33 EFRAG agrees with the IASB's proposed disclosure objective and the disclosure requirements as proposed in the ED. EFRAG notes that the focus of the disclosure requirements in the ED is to help user to understand the implications of a lack of exchangeability on the entity's financial statement.

34 EFRAG also considers that requiring disclosures about the estimation process and possible management estimates that are accompanying the assessment of a lack of exchangeability could potentially lead to duplicate information, because other standards require separate disclosures for such kind of information. Therefore, EFRAG supports the ED`s proposal to prevent duplicate disclosures when information is disclosed elsewhere in the financial statements.

35 EFRAG suggests including an additional disclosure requirement about situations where entities are not able to access foreign capital resources on a non-temporary basis (locked in capital). In such situations it should be useful to understand the impact of restrictions.

Question to Constituents

36 In your view, would you consider additional disclosure requirements, that are not separately specified in the Exposure Draft or already required by other standards, as necessary? The circumstances of a lack of exchangeability are often of a delicate political situation. Should therefore the disclosure requirements allow entities more flexibility (e.g., through an exemption) in regard to providing information on the nature of a lack of exchangeability and information on the inputs used. For example, this would apply when the lack of exchangeability results from a political situation, or when an entity needs to use an unofficial exchange market in order to exchange the local currency? Please explain your answer.

Notes to constituents – Transition (Question 4)

Preparers already applying IFRS

37 The ED proposes that an entity shall apply those amendments from the beginning of annual reporting periods beginning on or after the initial application date, as determined by the IASB, whereby earlier application is permitted.

38 The ED proposes that 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, 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, 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.

First-time adopters

39 First-time adopters are required to apply IAS 21 retrospectively with some relief as the cumulative translation difference could be deemed zero for all foreign operations at its date of transition to IFRS.

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.

EFRAG’s response

EFRAG generally supports the proposed transition requirements. EFRAG considers that the proposed transition requirements will impact intra period comparability of financial statements. EFRAG agrees with the IASB`s view that the benefits of retrospective application would not outweigh the costs.

EFRAG agrees to the IASB`s view that additional transition requirements for first -time adopters are not required.

40 EFRAG generally supports the proposed transition requirements as retrospective application 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 costly and likely to require the use of hindsight.

41 EFRAG agrees that the effects of initial application shall be recognized as an adjustment to the opening balance of retained earnings when the entity reports foreign currency transactions. EFRAG supports the IASB`s view that separately tracking any exchange differences recognised in other comprehensive income would introduce unnecessary complexity.

42 EFRAG also agrees that the effects of initial application shall be recognized as an adjustment to 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, as those exchange differences are generally recognised in other comprehensive income and accumulated in a separate component of equity.

43 EFRAG agrees to the IASB`s view that additional transition requirements for first -time adopters are not required as guidance in IFRS 1 requires the retrospective application of IAS 21, while allowing first-time adopter to deem the cumulative translation difference for all foreign operations to be zero at its date of transition to IFRS.