Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

ASCG • Joachimsthaler Str. 34 • 10719 Berlin

Jean-Paul Gauzès
EFRAG Board President
35 Square de Meeûs
B-1000 Brussels

IFRS Technical Committee
Phone: +49 (0)30 206412-12
E-Mail: info@drsc.de

Berlin, 24 June 2021

Dear Jean-Paul,

IASB Exposure Draft ED/2021/4 *Lack of Exchangeability*

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to contribute to EFRAG's Draft Comment Letter (herein referred to as 'DCL') on the IASB's ED/2021/4 *Lack of Exchangeability* (herein referred to as 'ED') by providing our feedback vis-à-vis the IASB.

We provide our response to EFRAG's questions to constituents in the appendix of this letter and attach our comment letter to the IASB, containing our detailed comments on the questions raised in the ED.

If you would like to discuss our comments further, please do not hesitate to contact Olga Bultmann (bultmann@drsc.de) or me.

Yours sincerely,

Sven Morich

Vice President

Appendix – Answers to the questions in the DCL

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

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?

In our view, the use of an observable exchange rate should be permitted as proposed in the ED. In the specific situations where the spot exchange rate is not objectifiable, an entity should have the flexibility to find the most economically reasonable solution in determining the spot exchange rate. Thus, the economic content should have priority over objectivity.

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

If no objectifiable exchange rate exists, the official exchange rate is typically used, even though this exchange rate does not faithfully reflect the prevailing economic conditions.

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

According to IAS 21, an entity's functional currency can be changed only if there is a change to the underlying transactions, events, and conditions relevant to the entity. Therefore, an entity assesses whether the lacking exchangeability leads to changes of those underlying transactions, events, and conditions of a foreign operation: If yes, an entity changes the functional currency of this foreign operation by applying IAS 21.

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?

Yes, we consider additional guidance as necessary. In our view, this guidance should be in form of illustrative examples on how an entity would reasonably estimate the exchange rate when there is no observable exchange rate or when the observable exchange rate does not meet the conditions of an estimated spot rate in paragraph 19A. Please also refer to our comments on Question 2 in the comment letter to the IASB attached below.

Question 3 – Disclosure

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.

We do not consider necessary to introduce additional disclosure requirements that are not separately specified in the ED or already required by other standards. The information about the nature of a lack of exchangeability and the inputs used in estimating the spot exchange rate are relevant and important to enable users to understand how the lack of exchangeability affects the entity's financial statements. This information is especially important when an entity estimates the spot exchange rate because no observable exchange rate exists or because the observable exchange rate does not meet the conditions in paragraph 19A of the ED. We note that an entity has to comply with the necessary IFRS disclosure requirements in other accounting matters, too, and that the affected entities might have to find ways to protect their sensitive corporate data in that context. From our perspective, just as in other situations, there are multiple ways to describe circumstances of a lack of exchangeability so that the delicate political situation is not described too negatively. For this reason, an exemption from disclosures in the case of lacking exchangeability does not seem justified.

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ASCG • Joachimsthaler Str. 34 • 10719 Berlin

Prof Dr Andreas Barckow
Chair of the
International Accounting Standards Board
Columbus Building
7 Westferry Circus / Canary Wharf
London E14 4HD

IFRS Technical Committee
Phone: +49 (0)30 206412-12
E-Mail: info@drsc.de

Berlin, 15 Jul 2021

Dear Andreas,

IASB Exposure Draft ED/2021/4 *Lack of Exchangeability*

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the Exposure Draft ED/2021/4 *Lack of Exchangeability* issued by the IASB on 20 April 2021 (herein referred to as 'ED'). We appreciate the opportunity to comment on the proposals.

We note that there is a diversity in practice on how to assess the lack of exchangeability of a currency and to determine the spot exchange rate to be used in the absence of exchangeability. Therefore, we welcome the ED and the IASB's efforts to create provisions that would help companies determine whether a currency can be exchanged into another currency and what accounting to apply if the currency cannot be exchanged.

We support the Board's decision to develop a framework to support the estimation process instead of proposing detailed requirements or specifying a particular estimation technique.

However, we suggest including some illustrative examples on how an entity would reasonably estimate the exchange rate when there is no observable exchange rate, or when the observable exchange rate does not meet the conditions of an estimated spot rate in paragraph 19A. Further, we believe it would be helpful if the Board illustrated how an entity would reflect inflation in estimating the spot exchange rate in an example.

Our responses to the questions of the ED are laid out in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Olga Bultmann (bultmann@drsc.de) or me.

Yours sincerely,

Sven Morich

Vice President

Appendix – Answers to the questions in the ED

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.

We agree with the proposed amendments regarding the assessment of lack of exchangeability.

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.

We welcome the proposal that an entity estimates the spot exchange rate when a currency is not exchangeable into another currency. We generally agree with the proposed approach on how an entity determines the spot exchange rate in this case.

We share the IASB's view that the estimation of a spot exchange rate depends on entity-specific and jurisdiction-specific facts and circumstances. We, therefore, support the Board's decision to develop a framework to support the estimation process instead of proposing detailed requirements or specifing a particular estimation technique.

However, we suggest including some illustrative examples on how an entity would reasonably estimate the exchange rate when there is no observable exchange rate, or when the observable exchange rate does not meet the conditions of an estimated spot rate in paragraph 19A. We would welcome it if the IASB developed examples of the estimation procedures based on real circumstances, e.g., lacking exchangeability in Venezuela a few years ago or currently in Lebanon.

In our view, these examples should address the cases when some of the conditions listed in paragraph A13 are not met and illustrate how an entity would reflect these facts in estimating the exchange rate.

Further, we note that distortions in the consolidated financial statements arise if a foreign operation whose functional currency is that of a hyperinflationary economy restates its financial statements in accordance with IAS 29 *Financial Reporting in Hyperinflationary Economies* and where the exchange rate for purposes of translating the financial statements of this foreign operation into the presentation currency applying IAS 21 does not or not enough reflect inflation. The original question submitted to the IFRS Interpretations Committee referred to cases where the effects of hyperinflation were not offset by a corresponding reduction in the exchange rate (because, for example, there is only one 'official' fixed exchange rate). In our understanding of the proposals in the ED, an entity would apply judgement in estimating the spot exchange rate in those situations. We deem that an entity would need to consider, inter alia, inflation in exercising this judgement. We believe it would be helpful if the Board illustrated how an entity would reflect inflation in estimating the spot exchange rate in an example.

In our view, without such illustrative examples of possible reasonable estimation procedures, the proposed provisions would not contribute to a noticeable reduction of diversity in practice.

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.

We agree with the proposed disclosure requirements.

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.

We agree with the proposed transition requirements.