IFRS in Focus

IASB proposes amendments to IAS 21 to specify when a currency is exchangeable and how to determine the exchange rate when it is not

Contents

Background

The proposed amendment

Effective date, transitional provisions and comment period

Further information

This *IFRS in Focus* outlines the proposed amendments to IAS 21 *The Effects of Foreign Exchange Rates* set out in ED/2021/4 *Lack of Exchangeability,* published by the International Accounting Standards Board (Board) in April 2021.

- The Board proposes to amend IAS 21 to specify when a currency is exchangeable into another currency and, consequently, when it is not.
- The amendments, if finalised, would also specify how an entity determines the exchange rate to apply when a currency is not exchangeable.
- It is proposed that an entity would disclose information that enables users of its financial statements to evaluate how a currency's lack of exchangeability affects, or is expected to affect, its financial performance, financial position and cash flows.
- The ED does not propose an effective date, however early application is proposed to be permitted. If finalised, an entity would apply the amendments from the beginning of the annual reporting period beginning on or after the effective date. The comment period for the ED ends on 1 September 2021.

Background

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

There are diverse views on how to determine whether a currency is exchangeable into another currency and the exchange rate to use when it is not. This could lead to material differences in the financial statements of entities affected by a currency that lacks exchangeability. The Board is therefore proposing to add requirements to IAS 21 for an entity to determine whether a currency is exchangeable into another currency, and accounting requirements to apply when it is not.

The proposed amendment

Assessing whether a currency is exchangeable

The Board proposes to amend IAS 21 to clarify that a currency is exchangeable into another currency when an entity is able to exchange that currency for the other currency. The amendments would add an appendix to IAS 21 that sets out factors an entity would consider in assessing whether a currency is exchangeable and specify how those factors affect the assessment. The appendix would specify the following:

- A currency is exchangeable into another currency even if the exchange transaction includes a normal administrative delay, for example legal or regulatory requirements applying to some exchange transactions or practical reasons such as statutory holidays
- A currency is exchangeable if an entity is able to obtain the other currency regardless of whether it intends or decides to do so
- An entity considers only markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

- Jurisdictional authorities might set a preferential exchange rate for imports of goods and a 'penalty' exchange rate for capital remittances to other jurisdictions or make the currency available only to pay for imports of goods but not for capital remittances to other jurisdictions. In this case, an entity assesses exchangeability by assuming the purpose of obtaining the currency is to:
  - Settle individual foreign currency transactions, assets or liabilities for foreign currency transactions in the entity's functional currency
  - Realise the entity's net assets for the use of a presentation currency other than its functional currency
  - Realise the entity's net investment in a foreign operation for translating the results and financial position of that foreign operation
- A currency is not exchangeable into another currency when an entity can only obtain an insignificant amount of the other currency. This is assessed by comparing the amount that can be obtained for a specified purpose with the total amount required for that purpose

Observation

The Board considered different alternatives for assessing whether a currency is exchangeable into another currency when an entity is only able to obtain some amounts of another currency. For example, the Board considered that a currency could be exchangeable into another currency if the entity can get any amount of that other currency. However, the Board found that alternative very narrow and considered that it would result in a lack of exchangeability only in the most extreme situations. At the other extreme, the Board considered whether exchangeability should only be assumed when an entity is able to obtain the entire amount of the other currency. That alternative was dismissed as too broad, given it would lead to a lack of exchangeability in many situations.

The Board proposes to add examples to IAS 21 that illustrate how an entity assesses whether a currency is exchangeable into another currency.

Determining the spot exchange rate when a currency is not exchangeable

The ED proposes to specify how an entity determines the spot exchange rate when a currency is not exchangeable into another currency at a measurement date. In that case, an entity would estimate the spot exchange rate. The estimated spot exchange rate would have to meet the following three conditions assessed at the measurement date:

- A rate at which the entity would have been able to enter into an exchange transaction had the currency been exchangeable into the other currency
- A rate that would have applied to an orderly transaction between market participants
- A rate that faithfully reflects the prevailing economic conditions

An entity may use an observable exchange rate as the estimated spot exchange rate if it meets the requirements above and is either a spot exchange rate for a purpose other than that for which the entity assesses exchangeability or is the first exchange rate at which an entity is able to obtain the other currency after exchangeability of that currency is restored (first subsequent exchange rate).

The proposed appendix to IAS 21 would provide further guidance on how an entity assesses whether an estimated rate meets the conditions above. In particular, to assess whether it can use:

- A spot exchange rate that is available only for another purpose, an entity would consider the following indicators:
  - Whether several exchange rates exist for a currency—the existence of more than one observable exchange rate may include an 'incentive' or 'penalty' and may therefore not faithfully reflect the prevailing economic conditions
  - The purpose for which the currency is exchangeable—if an entity is able to obtain the other currency only for limited purposes, the observable exchange rate may not faithfully reflect the prevailing economic conditions
  - The nature of the exchange rate—a free-floating observable exchange rate is more likely to faithfully reflect the prevailing economic conditions than an observable exchange rate set through regular interventions from the relevant monetary or jurisdictional authorities
  - The frequency with which exchange rates are updated—if an observable exchange rate does not change over a period of time, it is less likely to faithfully reflect the prevailing economic conditions than an observable exchange rate that is updated more frequently (i.e. one or more times a day)
- The first subsequent exchange rate, an entity would consider:
  - 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 is to faithfully reflect the prevailing economic conditions
  - Inflation rates—if the currency is the currency of an economy that is subject to hyperinflation or high rates of inflation, the first subsequent observable exchange rate for a currency of such an economy may not faithfully reflect the prevailing economic conditions

Observation

The Board considered, but decided against, permitting or requiring the use of a blended exchange rate when an entity is able to obtain only limited amounts of the other currency. The blended exchange rate would have been 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. However, the Board found that determining a blended exchange rate could be difficult, and, given the requirements proposed for assessing whether a currency is exchangeable into another currency, the portion for which an observable rate could be used would be insignificant, as the currency would otherwise be considered exchangeable and no estimation would be required.

The Board proposes to add examples to IAS 21 that illustrate how an entity determines an appropriate spot exchange rate when a currency is not exchangeable.

Disclosures

If the amendments are finalised, an entity would be required to disclose information that would enable users of its financial statements to evaluate how lack of exchangeability between two currencies affects, or is expected to affect, its financial performance, financial position and cash flows. To achieve this objective, an entity would disclose information about:

- The nature and financial effects of a lack of exchangeability
- The spot exchange rate(s) used
- The estimation process
- The risk to which the entity is exposed

The proposed appendix to IAS 21 contains guidance on how an entity meets the disclosure objective.

First-time adopters

The Board proposes that a specific exemption from retrospective application of the amendments would not be necessary for a first-time adopter. Accordingly, only a minor change is proposed to IFRS 1 *First-time Adoption of International Financial Reporting Standards* to align the wording in IFRS 1 with the proposed amendments.

Effective date, transitional provisions and comment period

The ED does not include an effective date for the proposed amendments to IAS 21. Earlier application is proposed to be permitted.

Should the amendments be finalised, the Board proposes that an entity would apply the amendments from the beginning of the annual reporting period beginning on or after the effective date. The ED proposes detailed transition requirements on how items in the statement of financial position are translated in specific circumstances. The comment period for the ED ends on 1 September 2021.

Further information

If you have any questions about the proposed amendments to IAS 21, please speak to your usual Deloitte contact or get in touch with a contact identified in this *IFRS in Focus*.

The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosures literature. iGAAP on DART allows access to the full IFRS Standards, linking to and from:

- Deloitte’s authoritative, up-to-date, iGAAP manuals which provide guidance for reporting under IFRS Standards; and
- Model financial statements for entities reporting under IFRS Standards.

To apply for a subscription to DART, click here to start the application process and select the iGAAP package.

For more information about DART, including pricing of the subscription packages, click here.

Key contacts

Global IFRS Leader
Veronica Poole
ifrsglobalofficeuk@deloitte.co.uk

IFRS Centres of Excellence

Americas		
Argentina	Fernando Lattuca	**arifrscoe@deloitte.com**
Canada	Karen Higgins	**ifrsca@deloitte.ca**
Mexico	Miguel Millan	**mx_ifrs_coe@deloittemx.com**
United States	Robert Uhl	**IAS Plus-us@deloitte.com**
Asia-Pacific	Shinya Iwasaki	**ifrs-ap@deloitte.com**
Australia	Anna Crawford	**ifrs@deloitte.com.au**
China	Gordon Lee	**ifrs@deloitte.com.cn**
Japan	Kazuaki Furuuchi	**ifrs@tohmatsu.co.jp**
Singapore	Lin Leng Soh	**ifrs-sg@deloitte.com**
Europe-Africa		
Belgium	Thomas Carlier	**ifrs-belgium@deloitte.com**
Denmark	Søren Nielsen	**ifrs@deloitte.dk**
France	Laurence Rivat	**ifrs@deloitte.fr**
Germany	Jens Berger	**ifrs@deloitte.de**
Italy	Massimiliano Semprini	**ifrs-it@deloitte.it**
Luxembourg	Martin Flaunet	**ifrs@deloitte.lu**
Netherlands	Ralph Ter Hoeven	**ifrs@deloitte.nl**
Russia	Maria Proshina	**ifrs@deloitte.ru**
South Africa	Nita Ranchod	**ifrs@deloitte.co.za**
Spain	Jose Luis Daroca	**ifrs@deloitte.es**
Switzerland	Nadine Kusche	**ifrsdesk@deloitte.ch**
United Kingdom	Elizabeth Chrispin	**deloitteifrs@deloitte.co.uk**

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organisation"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our global network of member firms and related entities in more than 150 countries and territories (collectively, the "Deloitte organisation") serves four out of five Fortune Global 500® companies. Learn how Deloitte's approximately 330,000 people make an impact that matters at www.deloitte.com.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms or their related entities (collectively, the "Deloitte organisation") is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser.

No representations, warranties or undertakings (express or implied) are given as to the accuracy or completeness of the information in this communication, and none of DTTL, its member firms, related entities, employees or agents shall be liable or responsible for any loss or damage whatsoever arising directly or indirectly in connection with any person relying on this communication. DTTL and each of its member firms, and their related entities, are legally separate and independent entities.

© 2021. For information, contact Deloitte Global.

Designed by Deloitte CoRe Creative Services. RITM0709639