

EFRAG's Draft Letter to the European Commission Regarding Endorsement of the amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates: Lack of Exchangeability*

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European Commission
1049 Brussels

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Dear Mr John Berrigan

Endorsement of the amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates: Lack of Exchangeability*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on the amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates: Lack of Exchangeability* ('the Amendments'), which were issued by the IASB on 15 August 2023. An Exposure Draft of the Amendments was issued on 20 April 2021. EFRAG provided its comment letter on that Exposure Draft on 14 September 2021.

The objective of the Amendments is to provide guidance on when to conclude that a currency is not exchangeable into another currency, how to set an exchange rate in those situations and what information to provide when a currency is not exchangeable.

The amendments to IAS 21 are applicable for annual periods beginning on or after 1 January 2025, with earlier application permitted. If entities apply these amendments earlier, they shall disclose that fact. A description of the Amendments is included in Appendix 1 to this letter.

In applying the Amendments, an entity shall not restate comparative information. Instead, the entity shall, at the date of initial application, recognise any effect of initially applying the amendments as an adjustment to equity.

In order to provide our endorsement advice as you have requested, we have first assessed whether the Amendments would meet the technical criteria for endorsement, in other words, whether the Amendments would provide relevant, reliable, comparable, and understandable information required to support economic decisions and the assessment of stewardship, lead to prudent accounting and not be contrary to the true and fair view principle. We have then assessed whether the Amendments would be conducive to the European public good. We provide our [tentative] conclusions below.

Do the Amendments meet the IAS Regulation technical endorsement criteria?

EFRAG has [tentatively] concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability, and understandability required to support economic decisions and the assessment of stewardship and raise no issues regarding prudent accounting. EFRAG has also [tentatively] concluded that the Amendments do not create any

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distortion in their interaction with other IFRS Standards and that all necessary disclosures are required. Therefore, EFRAG has [tentatively] concluded that the Amendments are not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Are the Amendments conducive to the European public good?

EFRAG has assessed that the Amendments would improve financial reporting and EFRAG expects that the benefits of applying the Amendments would likely outweigh the costs of their application. EFRAG has not identified that the Amendments could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG [tentatively] concluded that endorsing the Amendments is conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

Our advice to the European Commission

As explained above, we have [tentatively] concluded that the Amendments meet the qualitative characteristics of relevance, reliability, comparability, and understandability required to support economic decisions and the assessment of stewardship and raise no issues regarding prudent accounting. We have also [tentatively] concluded that the Amendments are conducive to the European public good. Therefore, we [tentatively] recommend the Amendments for endorsement.

On behalf of EFRAG, I would be happy to discuss our [tentative] advice with you, other officials of the European Commission or the Accounting Regulatory Committee.

Yours sincerely,

Wolf Klinz,
Chair of the EFRAG FRB

Appendix 1: Understanding the changes brought about by the Amendments

Background of the Amendments

- 1 The Amendments are complementing the agenda decision of the IFRS Interpretations Committee published in September 2018. That agenda decision was issued in relation to the lack of exchangeability of Venezuelan *Bolívar* and the request to clarify whether an official rate can be used as a spot exchange rate in such a situation. The IFRS literature existing at that time left room for interpretations.
- 2 IAS 21 generally requires the use of a spot exchange rate when an entity reports foreign currency transactions or a foreign operation's results and financial position in its financial statements. A spot exchange rate is the exchange rate for immediate delivery. IAS 21 specifies the exchange rate to use in reporting foreign currency transactions when exchangeability between two currencies is temporarily lacking. However, IAS 21 does not specify what an entity is required to do when this situation is not temporary.
- 3 The IASB was informed of diverse views on how to determine whether a currency is exchangeable into another currency and the exchange rate to use when it is not. In situations when economic conditions deteriorate rapidly, the diverse views on the application of IAS 21 could lead to material differences in the financial statements of entities affected by a currency that lacks exchangeability.
- 4 Furthermore, for hyperinflationary economies which may also be accompanied by the currency not being exchangeable, IAS 29 *Financial Reporting in Hyperinflationary Economies* requires the reporting entity to restate non-monetary assets and liabilities of the foreign subsidiary to reflect inflation by applying a general price index before retranslating the subsidiary's financial statements into the reporting currency.
- 5 The IASB proposed to amend IAS 21 and to specify:
 - (a) when a currency is exchangeable into another currency and, consequently, when it is not;
 - (b) how an entity determines the exchange rate to apply when a currency is not exchangeable; and
 - (c) the disclosures an entity provides when a currency is not exchangeable.

The issues and how they have been addressed

- 6 On 15 August 2023, the IASB issued the Amendments.
- 7 The Amendments require entities to apply a consistent approach in assessing whether a currency can be exchanged into another currency and, when it cannot, in determining the exchange rate to use and the disclosures to provide.

What do the Amendments change?

- 8 Paragraph 8 of IAS 21 is modified to clarify a definition of when a currency is exchangeable into another currency and when it is not. Paragraphs 8A and 8B are added to IAS 21 to further elaborate on the definition.
- 9 Paragraph 19A is added to explain the objective and the process to estimate a spot exchange rate when a currency is not exchangeable into another currency.

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- 10 Paragraph, 57A is added to provide guidance on disclosures on when the entity estimates a spot exchange rate because a currency is not exchangeable into another currency.
- 11 Application Guidance (paragraphs A1 - A20) is added to provide further detailed guidance on how to apply the above-mentioned principles. Application Guidance forms an integral part of IAS 21.
- 12 Illustrative Examples (IE) and relevant paragraphs in the Basis for Conclusions (BC) are added. However, IE and BC do not form integral parts of IAS 21 and are not endorsed for use in the EEA.

When do the Amendments become effective?

- 13 The amendments to IAS 21 are applicable for annual periods beginning on or after 1 January 2025, with earlier application permitted. If entities apply these amendments earlier, they shall disclose that fact.
- 14 In applying the Amendments, an entity shall not restate comparative information. Instead, the entity shall, at the date of initial application, recognise any effect of initially applying the amendments as an adjustment to equity as follows:
 - (a) when the entity reports foreign currency transactions in its functional currency - as an adjustment to the opening balance of retained earnings;
 - (b) when the entity uses a presentation currency other than its functional currency or translates the results and financial position of a foreign operation - as an adjustment to the cumulative amount of translation differences - accumulated in a separate component of equity.

Appendix 2: EFRAG's technical assessment on the Amendments against the endorsement criteria

Notes to Constituents:

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendments. In it, EFRAG assesses how the Amendments satisfy the technical criteria set out in the Regulation (EC) No 1606/2002 for the adoption of international accounting standards. It provides a detailed evaluation for the criteria of relevance, reliability, comparability, and understandability, so that financial information is appropriate for economic decisions and the assessment of stewardship. It evaluates separately whether the Amendments lead to prudent accounting and finally considers whether the Amendments would not be contrary to the true and fair view principle.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS Standards in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS Standard or Interpretation against the technical criteria for European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRS Standards or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Does the accounting that results from the application of the Amendments meet the technical criteria for endorsement in the European Union?

- 15 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words, that the Amendments:
 - (a) are not contrary to the principle set out in Article 4(3) of Council Directive 2013/34/EU (The Accounting Directive); and
 - (b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 16 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.

- 17 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive'* (Recital 9 of the IAS Regulation).
- 18 EFRAG's assessment as to whether the Amendments would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.
- 19 In its assessment, EFRAG has considered the Amendments from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of the Amendments is appropriate both for making decisions and assessing the stewardship of management.
- 20 EFRAG's assessment on whether the Amendments are not contrary to the true and fair view principle set out in Article 4(3) of Council Directive 2013/34/EU is based on the assessment of whether it meets all other technical criteria and whether they lead to prudent accounting. EFRAG's assessment also includes assessing whether the Amendments do not interact negatively with other IFRS Standards and whether all necessary disclosures are required. Detailed assessments are included in this appendix in the following paragraphs:
- (a) Relevance, see paragraphs 21-26;
 - (b) Reliability, see paragraphs 27-32;
 - (c) Comparability, see paragraphs 34-41;
 - (d) Understandability, see paragraphs 42-47;
 - (e) whether overall they lead to prudent accounting, see paragraphs 48 and 49; and
 - (f) whether they would not be contrary to the true and fair view principle, see paragraphs 50-53.

Relevance

- 21 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present, or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.
- 22 EFRAG considered whether the Amendments would result in the provision of relevant information - in other words, information that has predictive value, confirmatory value, or both - or whether it would result in the omission of relevant information.
- 23 EFRAG notes that, originally, the development of the Amendments was triggered by a submission to the IFRS Interpretations Committee to clarify how to apply the guidance of IAS 21 when a currency lacked exchangeability. Furthermore, the IASB, during its discussions, agreed that the IAS 21 guidance lacks the principles applicable when lack of exchangeability of one currency into another is not temporary.

- 24 The Amendments respond to the concerns about diversity in practice in accounting when a currency is not exchangeable into another currency. The Amendments address a matter previously partly not covered in the accounting requirements for the effects of changes in foreign exchange rates and, consequently, will help companies in applying the IFRS Accounting Standards consistently and will help users in understanding the impact when a currency is not exchangeable into another currency.
- 25 Moreover, EFRAG notes that the Amendments require an entity to provide disclosures when the entity estimates a spot exchange rate because a currency is not exchangeable into another currency. This requirement is expected to lead to more relevant information being available.
- 26 EFRAG's [tentative] overall assessment is that the Amendments would result in the provision of relevant information and therefore satisfy the relevance criterion.

Reliability

- 27 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 28 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.
- 29 Firstly, EFRAG assesses that the new principles are not overly complex to apply and consequently the Amendments are expected to be applied as envisaged.
- 30 EFRAG similarly assesses that compliance with the requirements included in the Amendments would not result in biased information.
- 31 EFRAG also assesses that the Amendments would result in a faithful representation and enhance completeness of information. This is because the Amendments will require an entity to provide additional information on how a currency that is not exchangeable into another currency affects the situation of the entity.
- 32 EFRAG's [tentative] overall assessment is that the Amendments would result in the provision of reliable information and therefore satisfy the reliability criterion.

Comparability

- 33 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 34 EFRAG has considered whether the Amendments result in transactions that are:
- (a) economically similar being accounted for differently; or
 - (b) economically different being accounted for as if they were similar.
- 35 Regarding the issues addressed in the Amendments, a diversity in practice had been observed. This is because IAS 21 lacked guidance when lack of exchangeability of a currency was not temporary. The Amendments clarify how to assess whether a currency can be exchanged into another currency and, when it cannot, how to determine the exchange rate to use and what disclosures to provide. Consequently, the Amendments have the potential to enhance comparability, by reducing diversity in practice.

- 36 EFRAG notes that the Amendments do not require restating comparative information, and the effect of initial application will be recognised in the opening balance of equity at the date of initial application. Consequently, EFRAG notes that, in theory, the comparability in the context of year-to-year comparability of financial information may potentially be hindered.
- 37 However, EFRAG notes that a transition approach that would require 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 likely require the use of hindsight and, even if it were possible without hindsight, would be costly. Furthermore, EFRAG notes that the current number of currencies that cannot be exchanged into another currency is limited.
- 38 Consequently, EFRAG assesses that the transition approach of the Amendments results in an appropriate balance between the costs for preparers and the information provided to users.
- 39 EFRAG also notes that the Amendments do not introduce any application options, for instance an option to retrospectively restate the financial information and, therefore, the effect of non-comparable financial information is expected to be limited to the transition period.
- 40 Moreover, the Amendments require entities to apply a consistent approach in assessing whether a currency can be exchanged into another currency and when it cannot, and in determining the exchange rate to use and the disclosures to provide.
- 41 EFRAG's [tentative] overall assessment is that the Amendments would result in enhanced comparability in financial reporting when one or more currencies relevant for financial statements are not exchangeable.

Understandability

- 42 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.
- 43 Although there are a number of aspects related to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability, and comparability.
- 44 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will not be unduly complex.
- 45 In EFRAG's view, the Amendments do not introduce any complexity that may impair understandability.
- 46 Furthermore, EFRAG notes that the disclosure requirements introduced by the Amendments would provide information that increases the understandability of the information provided by entity in the financial statements.
- 47 Therefore, EFRAG's [tentative] overall assessment is that the Amendments satisfy the understandability criterion in all material respects.

Prudence

- 48 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated, and liabilities or expenses are not understated.
- 49 EFRAG has not identified any particular impact on prudence. EFRAG has therefore [tentatively] concluded that the Amendments raise no issues in relation to prudence as defined above.

True and Fair View Principle

- 50 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:
- (a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and
 - (b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.
- 51 EFRAG has assessed that the Amendments do not create any negative interactions with other IFRS Accounting Standards. Accordingly, EFRAG has assessed that the Amendments do not lead to unavoidable distortions or significant omissions and therefore do not impede financial statements from providing a true and fair view.
- 52 EFRAG has concluded that the appropriate disclosures, necessary to provide a complete and reliable depiction of how an entity's assets, liabilities, equity, income, expenses, and cash flows are affected in situations when a currency is not exchangeable, is required in the Amendments.
- 53 As a result, EFRAG [tentatively] assesses that the application of the Amendments would not lead to information that would be contrary to the true and fair view principle.

Conclusion

- 54 Accordingly, for the reasons set out above, EFRAG's [tentative] conclusion is that the Amendments meet the technical requirements for EU endorsement as set out in the IAS Regulation.

Appendix 3: Assessing whether the Amendments are conducive to the European public good

Introduction

- 1 EFRAG considered whether it would be conducive to the European public good to endorse the Amendments. In addition to its assessment included in Appendix 2, EFRAG has considered a number of issues in order to identify any potential negative effects for the European economy on the application of the Amendments. In doing this, EFRAG considered:
 - (a) Whether the Amendments improve financial reporting. This requires a comparison of the Amendments with the existing requirements and how it/they fit into IFRS Standards as a whole;
 - (b) The costs and benefits associated with the Amendments; and
 - (c) Whether the Amendments could have an adverse effect to the European economy, including financial stability and economic growth.
- 2 These assessments allow EFRAG to draw a [tentative] conclusion as to whether the Amendments are likely to be conducive to the European public good. If the assessment concludes that there is a net benefit, the Amendments will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of whether the Amendments are likely to improve the quality of financial reporting

- 3 EFRAG notes that the Amendments are designed to clarify the IAS 21 guidance and to require entities to apply a consistent approach in assessing whether a currency can be exchanged into another currency and, when it cannot. When a currency cannot be exchanged into another currency, the Amendments set clear objectives for the determination of the exchange rate to be used and the disclosures to be provided.
- 4 EFRAG has therefore [tentatively] assessed that the Amendments are likely to improve the quality of financial reporting.

EFRAG's analysis of the costs and benefits of the Amendments

- 5 EFRAG first considered the extent of the work. For some Standards or Interpretations, it might be necessary to carry out some extensive work, in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. However, in the case of the Amendments, EFRAG's view is that the cost and benefit implications can be assessed by carrying out a more modest amount of work.
- 6 Therefore, as explained more fully below in the main sections of this appendix, the approach that EFRAG has adopted has been to carry out detailed initial assessments of the likely costs and benefits of implementing the Amendments in the EU, to consult on the results of those initial assessments, and to finalise those assessments in light of the comments received.

Cost for preparers

- 7 EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.

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- 8 EFRAG's assessment is that the Amendments may have an initial one-off cost for preparers to familiarise with the application of the Amendments and to update the accounting policy documentation as well as internal information controls. Preparers may also have initial costs as they may need to apply changes in their systems. EFRAG notes that the number of entities that may be expected to be significantly affected by the Amendments is limited.
- 9 However, we do not expect these costs to be significant as the Amendments do not require restating the comparative information.
- 10 In EFRAG's opinion, the Amendments do not require entities to significantly increase the ongoing costs as these entities are already required to account for the situations of lacking exchangeability of one currency into another. In contrary, the Amendments intend to clarify the IAS 21 guidance and the approach considered in the Amendments might be operationally simpler to solve the accounting divergence.
- 11 Overall, EFRAG's assessment is that for preparers, the Amendments are likely to result in cost savings related to ongoing costs which will outweigh the one-off implementation costs.

Costs for users

- 12 EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.
- 13 EFRAG's assessment is that the Amendments may have an initial one-off cost for users to familiarise with the Amendments and to update their internal information systems.
- 14 However, users are not expected to incur more ongoing costs. In the contrary, the Amendments intend to clarify the IAS 21 guidance and reduce the divergence in practice, which may result in reduced ongoing costs.
- 15 Overall, EFRAG's assessment is that for users, the Amendments are likely to result in cost savings related to ongoing costs which will outweigh the one-off implementation costs.

Benefits for preparers and users

- 16 EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.
- 17 Users are likely to benefit from the reduced divergence in practice.
- 18 EFRAG's assessment is that while preparers will incur some costs relating to the initial implementation of the Amendments, they will benefit from the increased guidance and reduction in divergence.

Conclusion on the costs and benefits of the Amendments

- 19 EFRAG's [tentative] overall assessment is that the overall benefits are likely to outweigh the costs associated with the implementation and application of the Amendments.

Conclusion

- 20 EFRAG considers that the Amendments will generally bring improved financial reporting when compared to existing guidance. As such, their endorsement is

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conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship.

- 21 EFRAG has not identified that the Amendments could have any adverse effect to the European economy, including financial stability and economic growth.
- 22 Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good.
- 23 Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Amendments, EFRAG [tentatively] concludes that endorsing the Amendments is conducive to the European public good.