EFRAG
European Financial Reporting Advisory Group

Lack of Exchangeability

Feedback to respondents EFRAG Final Comment Letter on IASB Exposure Draft ED/2021/4 *Lack of Exchangeability*

November 2021

Summary of contents

Introduction

Objective of this feedback statement

EFRAG published its final comment letter on the IASB Exposure Draft *Lack of Exchangeability* (the ED) on 14 September 2021. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG's final comment letter. The feedback was received through outreach, and comment letters received.

Background to the ED

The IASB published the ED in April 2021 with comments requested by 1 September 2021. In the ED, in order to respond to the accounting issues related with lack of exchangeability of a currency, 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 information an entity provides when a currency is not exchangeable.

EFRAG notes that the proposed guidance would apply to a wider range of situations where the local currency lacks exchangeability due to the economic or political environment. Consequently, the scope of the guidance would apply not only to the exchangeability of Bolivar - Venezuelan local currency - which was the original reason for the submission to the IFRS Interpretations Committee, but also to currencies of other countries (for instance Lebanon and Argentina). Furthermore, the proposed guidance would also apply, to single transactions, and not only for translating financial statements of foreign operations for the purpose of consolidation.

Further details are available on the web page of the related EFRAG project and the IASB website.

EFRAG's draft comment letter

EFRAG published its Draft Comment Letter on the ED on 3 June 2021 (the DCL).

In the DCL, EFRAG initially assessed that the proposals may have a positive impact on financial reporting under IFRS, may reduce the divergence when a currency lacks exchangeability and may be expected to lead to more transparency regarding accounting policies applied.

Nevertheless, EFRAG proposed the IASB to clarify the relationship between the notion of '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.

Furthermore, EFRAG proposed the IASB to provide a numeric example to guide preparers on how the estimation process should look like in practice.

EFRAG also sought constituents' views on:

(a) the usage of parallel, unofficial, or "black" market currency rates when estimating spot exchange rates;

(b) the methods they currently use to adjust exchange rates of currencies that lack exchangeability; and

(c) eventual further information needs regarding the situations where a currency lack exchangeability.

Outreach activities

After the publication of its DCL, EFRAG organised a series of closed interviews with two preparers, with their operations affected by lack of exchangeability of a local currency, and four global audit firms, including a call with local specialist of one affected economy.

Comments received from respondents

In addition to outreach activities, EFRAG received nine comment letters from respondents. The comment letters are available on the related EFRAG's project page in the ***Documents*** section. A list of respondents is provided in Appendix 1 to this document. The comment letters received came from five National Standard Setters; one European Regulator; and three European preparers' organisations or preparers.

EFRAG's final comment letter

EFRAG published its final comment letter on 14 September 2021 and submitted it to the IASB.

In its comment letter, EFRAG generally agrees with the proposed amendments regarding the assessment of lack of exchangeability. However, EFRAG proposes the IASB to:

- consider whether the guidance on assessing lack of exchangeability should also address the existence of other legal indirect exchange mechanisms;
- introduce a rebuttable presumption on the preferred use of an observable exchange rate when estimating a spot exchange rate;
- include a reference to other legal indirect currency exchange mechanisms and to consider whether those rates would constitute an observable exchange rate when estimating a spot exchange rate.
- make limited additions regarding the disclosure requirements.

Detailed analysis of issues, comments received, and changes made to EFRAG's final comment letter

EFRAG's tentative views expressed in the draft comment letter and respondents' comments	**EFRAG's response to respondents' comments**
General comments and Cover Letter	
EFRAG's tentative position In principle, EFRAG agreed 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 considered that the proposals would lead to a reduction of divergency in practice, and an increase in transparency about what method is applied. EFRAG raises several requests to clarify the proposals in order to better align the proposals with the existing guidance. *Respondents' comments* Respondents generally agreed with EFRAG's initial position. Their detailed comments have been considered in further parts of the comment letter.	*EFRAG final position* EFRAG considered the positive feedback received and maintained its general position in the cover letter.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

Question 1 — Assessment of whether a currency lacks exchangeability

Proposals in the ED

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.

The assessment should also consider the ability to obtain the other currency, either directly or indirectly using another currency and the purpose of the exchange.

EFRAG's tentative position

EFRAG supported the proposed amendments regarding the assessment of lack of exchangeability and 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 proposed the IASB to clarify the guidance in some particular respects.

Respondents' comments

All comment letter respondents supported the objective and process of assessment whether a currency lacks exchangeability.

EFRAG's response to respondents' comments

EFRAG final position

EFRAG considered the positive feedback received from respondents and the feedback received from the interviews with affected participants and with global audit firms.

EFRAG therefore retained its position on the assessment.

However, EFRAG also applied some drafting changes, regarding:

- the use of blue chip swap transactions and other legal indirect exchange mechanisms;
- situation where a currency may lack exchangeability only in one direction i.e., a foreign currency may be exchangeable into a local currency at an unfavourable rate, and at the same time, no mechanism allows exchanging this local currency back into the foreign one.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

Question 2 — Estimating spot exchange rate

Proposals in the ED

The ED proposes to specify how to determine the spot exchange rate in circumstances when the currency is lacking exchangeability based on conditions to be met, albeit the ED does not propose detailed guidance on how to make such estimate and does not prescribe any estimation techniques. The ED requires that an estimated spot exchange rate shall meet the specified conditions assessed at the measurement date.

EFRAG's tentative position

EFRAG agreed with the proposed approach on how to determine the spot exchange rate when exchangeability is lacking. EFRAG also agreed with the proposed guidance to use a principles-based approach to estimate spot exchange rates.

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

Respondents' comments

All respondents supported the objective and process of assessment whether a currency lacks exchangeability.

However, the respondents also provided additional comments and requests.

EFRAG's response to respondents' comments

EFRAG final position

EFRAG considered the positive feedback received from respondents and the detailed feedback received during the interviews with affected participants and with global audit firms and decided to maintain its initial positive opinion.

In order to address respondents' concerns, EFRAG decided to request the IASB to introduce a rebuttable presumption on the preferred use of an observable exchange rate.

Moreover, EFRAG suggested the IASB to explicitly address the use of other legal indirect currency exchange mechanisms (for instance blue chip swap transactions) and to consider whether those rates would constitute an observable exchange rate. EFRAG also maintained its initial suggestion to suggest the IASB to explicitly address the use of observable but not official rates.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

Question 3 - Disclosure

Proposals in the ED

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.

EFRAG's tentative position

EFRAG agreed with the proposed disclosure objective and the disclosure requirements as proposed in the ED.

EFRAG however suggested 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).

Respondents' comments

All respondents agreed (or did not disagree or raise concerns) to the proposed disclosure requirements. None of the respondents proposed additional disclosure requirements on top of the existing and newly proposed ones.

EFRAG's response to respondents' comments

EFRAG final position

EFRAG considered the positive feedback received from constituents and the feedback received for the closed meetings with EFRAG Working Groups and decided to maintain its original position.

EFRAG however decided to suggest the IASB to add a disclosure requirement that would provide the details on movements in, and the year-end total amount of, accumulated translation reserve since lack of exchangeability occurred.

EFRAG's tentative views expressed in the draft comment letter and respondents' comments

Question 4 - Transition

Proposals in the ED

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. The ED proposes that an entity shall not restate comparative information.

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.

EFRAG's tentative position

EFRAG supported the proposed transition requirements. EFRAG considered that the proposed transition requirements will impact intra period comparability of financial statements. EFRAG agreed with the IASB`s view that the benefits of retrospective application would not outweigh the costs. EFRAG agreed to the IASB`s view that additional transition requirements for first -time adopters are not required.

Respondents' comments

All comment letter respondents agreed or did not disagree or raised concerns to the proposed transition requirements.

EFRAG's response to respondents' comments

EFRAG final position

EFRAG considered the positive feedback received from respondents and maintained its initial position in the final comment letter.

Appendix 1: List of respondents

Table 1: List of respondents

Name of respondent	***Country***	***Type / Category***
ASCG	Germany	National Standard Setter
ESMA	European	EU Regulator
OIC	Italy	National Standard Setter
ANC	France	National Standard Setter
ACTEO, AFEP, and MEDEF	France	Business organisations
DASC	Denmark	National Standard Setter
ICAC	Spain	National Standard Setter
Business Europe	European	Business organisation
Allianz Group	Germany	Preparer