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EFRAG's Draft Comment Letter on the IASB's Exposure Draft *Lack of Exchangeability*

Objective

- 1 On 20 April 2021, the IASB published Exposure Draft *Lack of Exchangeability* (the ED), with a 120-day comment period ending on 1 September 2021, where the IASB proposes to amend IAS 21 *The Effects of Changes in Foreign Exchange Rates*.
- 2 In response to the ED, on 3 June 2021, EFRAG published its Draft Comment letter on the ED (the DCL) and seeks constituents views by **26 August 2021**.
- 3 The objective of the session is to:
 - (a) Provide EFRAG CFSS members an update on the project;
 - (b) seek EFRAG CFSS members' preliminary views on the DCL; and
 - (c) discuss possibilities for further outreach.

Background

- 4 IAS 21 provides the requirements regarding how to account for foreign currency transactions and operations in financial statements, and also how to translate financial statements into a presentation currency. An entity is required to determine a functional currency (for each of its operations if necessary) based on the primary economic environment in which it operates and generally records foreign currency transactions using the spot conversion rate to that functional currency on the date of the transaction.
- 5 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,
- 6 However, IAS 21 does not provide any specific requirements on what exchange rate a reporting entity uses to translate the results and financial position of a foreign operation when a lack of exchangeability is not temporary.
- 7 The IASB has observed that those circumstances existed in Venezuela when the issue was taken to the IFRS Interpretations Committee in June 2018. In Venezuela, the jurisdictional authorities administer the exchangeability of the currency and allocate foreign currencies to entities/individuals mainly through an auction-based mechanism. The jurisdictional authorities set an official exchange rate that prevents the official exchange rate from being a free-floating rate. Furthermore, the entities have been unable for several years to exchange the currency to repatriate dividends or make investment-related payments.

- 8 The IASB has also observed that, in the past, diverse views on how to determine whether a currency is exchangeable into another currency, and which exchange rate to use when it is not, were developed by preparers. In the IASB's view diversity in practice could lead to material differences in the financial statements of entities affected by a currency that lacks exchangeability.
- 9 Moreover, for hyperinflationary economies (which may also be accompanied by lack of exchangeability as well as it may be a separate issue), IAS 29 *Financial Reporting in Hyperinflationary Economies* requires the reporting entity to firstly restate non-monetary assets and liabilities of the foreign subsidiary to reflect inflation by applying a general price index before retranslating subsidiary's financial statement into reporting currency.

The proposed guidance and its scope

- 10 On 20 April 2021, in order to respond to the issues related with 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.
- 11 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 Venezuelan local currency, but also to other currencies. 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.

EFRAG's DCL

- 12 In the DCL, EFRAG initially assesses that the proposals may have a positive impact on financial reporting under IFRS and may reduce the divergence in practice in regard to accounting for foreign transactions and operations for which foreign currency lacks exchangeability and would lead to more transparency of accounting policies applied.
- 13 Nevertheless, 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.
- 14 Furthermore, EFRAG proposes the IASB to provide a numeric example to guide preparers on how the estimation process should look like in practice.
- 15 EFRAG also seeks constituents views on:
 - (a) the usage of 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;
 - (c) eventual further information needs regarding the situations where a currency lack exchangeability.

Planned outreaches

- 16 Apart from publishing the DCL EFRAG Secretariat plans to further consult the DCL with EFRAG Working Groups: RRAWG, IAWG, and EFRAG User Panel. The FIWG has already been consulted.
- 17 We also seek possibilities to discuss the proposed amendments with the members of EFRAG CFSS expecting a significant impact of the proposals on the financial statements of companies in their jurisdiction.

Questions for EFRAG CFSS members

- 18 Do you have comments on the EFRAG's draft comment letter on the ED?
- 19 Do you expect a significant impact of the proposed amendment on the companies in your jurisdiction? In which industries?
- 20 Are you planning any outreach activities (including a combination with other activities)? Would you consider interviews with preparers or a survey to preparers being useful?
- 21 What are your comments on the issues listed in the paragraph 15 above?

Agenda Papers

- 22 In addition to this issues paper:
 - (a) the ED is available on the IFRS Foundation web site on IFRS Foundation's website: <https://www.ifrs.org/content/ed2021-4-lack-of-exchangeability-ias-21.pdf>
 - (b) EFRAG's DCL is available on EFRAG's website: https://www.efrag.org/Assets/Download?assetUrl=%2fsites%2fwebpublishing%2fSiteAssets%2fEFRAG_Draft_Comment_Letter_-_Lack_of_Exchangeability.pdf