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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*

John Berrigan
Director General, Financial Stability, Financial Services and Capital Markets Union
European Commission
1049 Brussels

[dd] ~~Month~~ January 2024

Dear Mr 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* including amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* ('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 guide entities in when to conclude that a currency is not exchangeable into another currency, how to set an exchange rate in those situations and how to provide relevant disclosures in their financial statements when a currency cannot be exchanged into another currency.

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. The amendments to IFRS 1 are applicable as of the date when the amended IAS 21 is applied. 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.

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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 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 would reach an acceptable cost-benefit trade-off. 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 as you may wish.

Yours sincerely,

Wolf Klinz,
Chair of the EFRAG FRB

Appendix 1: Understanding the changes brought about by the Amendments

Background of the Amendments

1. 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.
2. 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.
3. 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 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.
4. 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

5. On 15 August 2023, the IASB issued the Amendments.
6. 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 has changed?

7. 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 further elaborate on the definition.
8. 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.
9. Paragraph, 57A is added to provide guidance on disclosures required by an entity to provide when the entity estimates a spot exchange rate because a currency is not exchangeable into another currency.

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10. Application Guidance (paragraphs A1 – A20) is added to provide further detailed guidance on how to apply the above-mentioned principles. AP forms an integral part of IAS 21.
11. Illustrative Examples and relevant Basis for Conclusions are added. However, IE and BC do not form integral parts of IAS 21 and are not endorsed for use in EEA.

When do the Amendments become effective?

12. 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. The amendments to IFRS 1 are applicable as of the date when the amended IAS 21 is applied.
13. 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.

Monitoring and subsequent retrospective evaluation

14. In the early stage of the application of the Amendments, EFRAG will monitor any issues that arise through:
 - a. Comments made directly to EFRAG; and
 - b. Issues raised to the IASB through its IFRS Interpretations Committee or through the planned processes for issues to be identified through the IASB's website.
15. In the longer term, the IASB will conduct a post-implementation review as required by the IASB Due Process handbook. Post-implementation reviews are normally carried out two years after new requirements have become mandatory and been implemented. EFRAG will participate in this review process and will actively seek comments from constituents.

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

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

14-16. 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.

15-17. 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.

16-18. 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).

17-19. 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.

18-20. 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.

19-21. 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 they meet 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 22-27;
- b. Reliability, see paragraphs 28-34;
- c. Comparability, see paragraphs 35-42;
- d. Understandability, see paragraphs 43-48;
- e. whether overall they lead to prudent accounting, see paragraphs 49-50; and
- f. Whether they would not be contrary to the true and fair view principle, see paragraphs 51-54.

Relevance

20-22. 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.

21-23. 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.

22-24. 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.

23-25. 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 and investors in applying the IFRS Accounting Standards.

24-26. 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.

25-27. EFRAG's **[tentative]** overall assessment is that the Amendments would result in the provision of relevant information and therefore satisfy the relevance criterion.

Reliability

26-28. 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.

27-29. There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

28-30. Firstly, EFRAG assesses that the new principles are not overly complex to apply and consequently the Amendments are expected to lead to financial information that contains no material errors.

29-31. EFRAG similarly assesses that compliance with the requirements included in the Amendments would not result in biased information.

30-32. 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 makes the information to be provided by an entity to satisfy the disclosure objective more reliable.

31-33. 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.

32-34. EFRAG's ~~tentative~~ overall assessment is that the Amendments would result in the provision of reliable information and therefore satisfy the reliability criterion.

Comparability

33-35. 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.

34-36. EFRAG has considered whether the Amendments result in transactions that are:

- a. economically similar being accounted for differently; or
- b. transactions that are economically different being accounted for as if they are similar.

35-37. 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, in reducing the diversity in practice.

36-38. EFRAG notes, that the Amendments do not require restating the comparative information, and the effect of the 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.

37-39. 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 be likely to require the use of hindsight and, even if possible without hindsight, would be costly. Furthermore, EFRAG notes that the current number of currencies that cannot be exchanged into another currency is limited.

~~38-40~~. 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.

~~39-41~~. 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 incomparable financial information is expected to be limited to the transition period.

~~40-42~~. 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

~~41-43~~. 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.

~~42-44~~. 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.

~~43-45~~. 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.

~~44-46~~. In EFRAG's view, the Amendments do not introduce any complexity that may impair understandability.

~~45-47~~. 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.

~~46-48~~. Therefore, EFRAG's ~~[tentative]~~ overall assessment is that the Amendments satisfy the understandability criterion in all material respects.

Prudence

~~47-49~~. 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.

~~48-50~~. 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

49-51. 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.

50-52. 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.

51-53. 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.

52-54. 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

53-55. 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 Document] [is/are] conducive to the European public good

Introduction

54-56. 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.

55-57. 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 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

56-58. 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 sets clear objectives for the determination of the exchange rate to be used and the disclosures to be provided.

57-59. 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

58-60. 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.

59-61. 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

60-62. EFRAG has carried out an assessment of the cost implications for preparers resulting from the Amendments.

61-63. 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.

62-64. However, we do not expect these costs to be significant as the Amendments do not require restating the comparative information.

63-65. In EFRAG's opinion, the Amendments do not require entities to significantly increase the ongoing costs as these entities already are 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.

64-66. Overall, EFRAG's assessment is that for preparers the Amendments are likely to result in the cost savings related to ongoing costs what will outweigh the one-off implementation costs.

Costs for users

65-67. EFRAG has carried out an assessment of the cost implications for users resulting from the Amendments.

66-68. 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.

67-69. However, users are not expected to incur more ongoing costs. In contrary, the Amendments intend to clarify the IAS 21 guidance and reduce the divergence in practise, what may result in the reduced ongoing costs.

68-70. Overall, EFRAG's assessment is that for users the Amendments are likely to result in the cost savings related to ongoing costs what will outweigh the one-off implementation costs.

Benefits for preparers and users

69-71. EFRAG has carried out an assessment of the benefits for users and preparers resulting from the Amendments.

70-72. Users are likely to benefit from the reduced divergence in practice.

71-73. EFRAG's assessment is that while preparers are less likely to benefit from the Amendments, as for some preparers there will be costs relating to the initial implementation of the Amendments, preparers will also benefit from the increased guidance and reduction in divergence.

Conclusion on the costs and benefits of the Amendments

72-74. EFRAG's **[tentative]** overall assessment is that the overall benefits are likely to outweigh the costs associated with the implementation of and applying the Amendments.

Conclusion

73-75. EFRAG believes that the Amendments will generally bring improved financial reporting when compared to existing guidance. As such, their endorsement is conducive to the European public good in that improved financial reporting improves transparency and assists in the assessment of management stewardship.

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~~74-76.~~ EFRAG has not identified the Amendments could have any adverse effect to the European economy, including financial stability and economic growth.

~~75-77.~~ Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good.

~~76-78.~~ 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.