European Securities and Markets Authority

The Chair

Date: 14 January 2016
ESMA/2016/37

Ms Françoise Flores
European Financial Reporting
Advisory Group (EFRAG)
35 Square de Meeûs
1000 Brussels
Belgium

Ref: Draft IFRIC Interpretation *Foreign Currency Transactions and Advance Consideration*

Dear Ms Flores,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to contribute to EFRAG's due process. ESMA has considered EFRAG's draft comment letter to the IFRS Interpretation Committee's (IFRS IC) draft IFRIC Interpretation *Foreign Currency Transactions and Advance Consideration*. We are pleased to provide you with the following comments with the aim of improving the enforceability of IFRSs and the transparency and decision usefulness of financial statements.

ESMA agrees with EFRAG that the question the IFRS IC addressed how to determine the date of a foreign currency transaction needed clarification. Therefore ESMA welcomes and supports the guidance proposed in the draft Interpretation.

We believe that both the one-transaction approach that was followed in the draft Interpretation and the multiple-transaction approach are consistent with the requirements in IAS 21 and have their merits but also their drawbacks. Like EFRAG, we therefore do not object to the IFRS IC's consensus as outlined in the draft Interpretation. However, we would recommend clarifying how the proposed Interpretation would apply to situations in which there is a significant financing component due to a consideration being received before the transfer of goods or services.

Our detailed comments on the draft Interpretation are set out in the Appendix I to this letter. Please do not hesitate to contact us should you wish to discuss all or any of the issues we have raised.

Yours sincerely,

Steven Maijoor

Appendix I – ESMA's detailed answers to the questions in the draft IFRIC Interpretation

Question 1 – Scope

The draft Interpretation addresses how to determine the date of the transaction for the purpose of determining the spot exchange rate used to translate foreign currency transactions on initial recognition in accordance with paragraphs 21–22 of IAS 21. Foreign currency transactions that are within the scope of the draft Interpretation are described in paragraphs 4–6 of the draft Interpretation.

Do you agree with the scope proposed in the draft Interpretation? If not, what do you propose and why?

1. As IAS 21 applies to all foreign currency transactions, ESMA agrees that the Interpretation should apply to a wide range of foreign currency transactions which contain advance payments or receipts in foreign currency. This will reduce diversity in practice where the respective standards under which the related asset, expense or income is accounted for are compatible with more than one possible interpretation of IAS 21.

2. We note that the scope of the draft Interpretation does not include transactions in which the prepayment asset or deferred income liability is a monetary item. Paragraphs 28 and 29 of IAS 21 require that for a monetary item an exchange difference is recognised in the income statement when there is a change in the exchange rate between the transaction date and the date of settlement of that asset or liability. We therefore agree that the issue which exchange rate to use on initial recognition of an asset, expense or income only arises when the advance consideration gives rise to a non-monetary prepayment asset or non-monetary deferred income liability.

3. ESMA also agrees with the exclusion of income taxes and insurance contracts from the scope of the draft Interpretation based on the complexities of accounting for income taxes and the fact that foreign exchange implications of insurance contracts are being addressed as part of the IASB's project on Insurance contracts.

Question 2 – Consensus

The consensus in the draft Interpretation provides guidance on how to determine the date of the transaction for the purpose of determining the spot exchange rate used to translate the asset, expense or income (or part of it) on initial recognition that relates to, and is recognised on the derecognition of, a non-monetary prepayment asset or a non-monetary deferred income liability (see paragraphs 8–11). The basis for the consensus is explained in paragraphs BC22–BC33. This includes the Interpretations Committee's consideration of the interaction of the draft Interpretation and the presentation in profit or loss of exchange differences arising on monetary items in accordance with paragraphs 28–29 of IAS 21 (see paragraphs BC32–BC33).

Do you agree with the consensus proposed in the draft Interpretation? If not, why and what alternative do you propose?

4. According to paragraph 21-22 of IAS 21 a foreign currency transaction shall be recorded on initial recognition in the functional currency by applying to the foreign currency amount the spot exchange rate at the date of the transaction. The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with IFRS.

5. IAS 21 is not entirely clear whether the payment of advance considerations and the transfer of goods or services are one transaction (one-transaction approach) or separate transactions (multiple-transaction approach). Following the one-transaction approach the transaction is recognised in the financial statements at the exchange rate at the date the advance payment or receipt of cash is initially recognised in the financial statements. Following the multiple-transaction approach the date of the transaction is the date of the transfer of goods or services. IFRS IC eventually concluded that the one-transaction approach is a more appropriate interpretation of IAS 21 as there is only one transaction, in which the payment and the transfer of goods or services are inherently interdependent.

6. The addressed issue seems to be prevalent and IAS 21 is not providing clear guidance how to determine the date of the transaction and thus the applicable spot rate. Considering these factors, we acknowledge that there might be diversity in practice, as also confirmed by the IFRS IC's outreach, even though in a limited outreach conducted by ESMA we did not identify such diversity in practice. Therefore we welcome that the IFRS IC provides guidance in this area. We believe that both the one-transaction approach and the multiple-transaction approach are consistent with the requirements in IAS 21 and have their merits but also their disadvantages. Therefore, ESMA does not object to the IFRS IC's consensus as expressed in the draft Interpretation.

7. ESMA agrees that the one-transaction approach reflects appropriately that an entity is no longer exposed to foreign exchange risk in respect of the transaction to the extent that it has received or paid any advance consideration.

8. However, ESMA also notes that according to the one-transaction approach the amount of revenue recognised would depend upon the timing of the receipt of the consideration. Furthermore, in some cases, the one-transaction approach might be inconsistent: e.g. in case only part of the consideration for a single good is paid or received in advance, more than one spot exchange rate would be used to translate the consideration in foreign currency at initial recognition of the acquired asset. This seems to imply that several transactions have taken place as according to paragraph 21 of IAS 21 the spot rate at the date of the transaction should be used. Consequently, this appears to be inconsistent with the basic assumption that the payment of the advance consideration and the transfer of goods and services represent only one single transaction.

9. ESMA recommends further clarifying how to account for significant financing components. According to the paragraphs 60-65 of IFRS 15 – *Revenue from Contracts*

with Customers an entity should adjust the consideration to reflect the time value of money in case there is a significant financing component. For example, if an entity concluded a contract to deliver goods in 2 years with a regular sales price of 100 foreign currency units, but allows the customer to reduce the consideration to 90 foreign currency units if it is paid immediately, a significant financing component might arise. ESMA believes it would be beneficial if the Interpretation would contain guidance on which exchange rate has to be used for the translation of the accreted amount.

Question 3 – Transition

On initial application, entities would apply the proposed Interpretation either:

(a) retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; or

(b) prospectively to all foreign currency assets, expenses and income in the scope of the proposed Interpretation initially recognised on or after:

> *(i) the beginning of the reporting period in which an entity first applies the proposed Interpretation; or*
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> *(ii) the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which an entity first applies the proposed Interpretation.*

Do you agree with the proposed transition requirements? If not, what do you propose and why?

10. We agree with the proposed transition requirements.