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# STAFF PAPER

June 2019

## IFRS® Interpretations Committee meeting

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| **Project** | **Lack of exchangeability (IAS 21)** |
| Paper topic | Cover memo and standard-setting approach |



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## Introduction and purpose

1. At its June and September 2018 meetings, the IFRS Interpretations Committee (Committee) considered the determination of the exchange rate an entity uses in particular circumstances to translate the results and financial position of a foreign operation into its presentation currency applying IAS 21 *The Effects of Changes in Exchange Rates*. As part of its analysis, the Committee observed that IAS 21 does not include explicit requirements on the exchange rate a reporting entity uses when the spot exchange rate (as defined in IAS 21) is not observable. Accordingly, the Committee decided to research possible narrow-scope standard-setting aimed at addressing the matter.

2. At the November 2018 meeting, we sought Committee members' feedback on our preliminary views on:

    (a) possible standard-setting to address the matter, and

    (b) requirements that could underpin standard-setting.

3. We detailed our preliminary view that the Committee could address the matter by (a) considering when exchangeability is lacking, and (b) developing requirements on

the exchange rate an entity uses in such circumstances. Agenda Papers 8, 8A and 8B of that meeting presented our preliminary views on these matters.

4. We did not ask the Committee to make any decision at that time. We explained that we would use the Committee's advice and feedback to refine our analysis and develop recommendations.

5. The purpose of this meeting is to ask the Committee whether it agrees with our recommendations on the scope and content of any amendment.

## Structure

6. This cover memo includes:

   (a) background information;

   (b) possible standard-setting approaches; and

   (c) our recommendations.

7. If the Committee agrees with our recommendation to undertake standard-setting, we will then ask the Committee whether it agrees with our recommendations in Agenda Papers 14A, 14B and 14C. In particular:

   (a) Agenda Paper 14A includes our analysis and recommendations on defining 'exchangeability' and, consequently, a 'lack of exchangeability';

   (b) Agenda Paper 14B includes our analysis and recommendations on how an entity determines the exchange rate when exchangeability is lacking; and

   (c) Agenda Paper 14C includes our analysis and recommendations on the disclosures that an entity provides when exchangeability is lacking.

## Background information

8. In 2018, the Committee considered the determination of the exchange rate an entity uses to translate the results and financial position of a foreign operation into its

presentation currency applying IAS 21. The Committee considered this matter in the following circumstances:

(a) the exchangeability of the foreign operation's functional currency with other currencies is administered by jurisdictional authorities. This exchange mechanism incorporates the use of an exchange rate set by the authorities (official exchange rate).

(b) the foreign operation's functional currency is subject to a long-term lack of exchangeability with other currencies—ie the exchangeability is not temporarily lacking as described in paragraph 26 of IAS 21; it has not been restored after the end of the reporting period.

(c) the lack of exchangeability with other currencies has resulted in the foreign operation being unable to access foreign currency using the exchange mechanism described in paragraph 8(a) above.

9. The Committee observed that those circumstances exist in Venezuela. The Committee discussed whether, in those circumstances, an entity is required to use an official exchange rate in applying IAS 21. The Committee published an agenda decision explaining how an entity applies IAS 21 in assessing whether it uses the official exchange rate to translate into its presentation currency the results and financial position of a foreign operation.

10. In addition, the Committee decided to research possible narrow-scope standard-setting aimed at addressing situations in which an entity might conclude that the spot exchange rate is not observable. Some respondents to the tentative agenda decision commented on the Committee's decision to undertake research—Appendix B of Agenda Paper 8 for the November 2018 Committee meeting reproduces those comments.

## Possible standard-setting approaches

### *Description of the approaches*

11. We have identified two possible narrow-scope standard-setting approaches to address the matter:

    (a) develop requirements on the exchange rate an entity uses in the limited circumstances described in the September 2018 agenda decision (ie the circumstances listed above in paragraph 8) [Alternative A]; or

    (b) consider more broadly when exchangeability is lacking and develop requirements on the exchange rate an entity uses in those circumstances [Alternative B].

12. In our view, only these two alternatives would result in standard-setting that neither reconsiders the fundamental requirements in IAS 21 nor addresses other aspects of IAS 21. As explained in November 2018, we recommend not reconsidering any fundamental requirements in IAS 21 or addressing other aspects of the Standard. This is because:

    (a) as part of its 2015 Agenda Consultation the Board decided not to undertake a project on IAS 21. We have not received new information that indicates the Board should revisit this decision;

    (b) addressing other aspects of IAS 21 would significantly broaden the scope of any project and would limit the Board and Committee's ability to develop any amendment for this matter in an efficient manner; and

    (c) the 2018 Committee's discussions emphasised that any amendment on this matter should be narrow in scope.

*Alternative A*

13. Alternative A would involve developing requirements on the exchange rate an entity applies only in the circumstances outlined in paragraph 8 of this paper. Accordingly, this alternative would not define a lack of exchangeability per se. It also would not consider requirements that entities could apply in circumstances in which there might

be some lack of exchangeability but not as extreme as those covered by the circumstances listed in paragraph 8.

14. Alternative A would (a) result in a targeted narrow-scope amendment to IAS 21 that would resolve a known problem in practice, and (b) be relatively simple to develop.

15. However, the benefits of this alternative would be limited. This is because Alternative A would address only extreme situations which do not occur frequently. For example, those circumstances might be reflective of the situation that currently exists in Venezuela but might have been too restrictive to capture the situation that had existed in Venezuela before 2018. In 2014, the circumstances in Venezuela were not as extreme as those that currently exist but were sufficiently severe to trigger a submission to the Committee.

*Alternative B*

16. Alternative B would involve:

    (a) considering more broadly what constitutes a currency's exchangeability and, consequently, its lack of exchangeability, and

    (b) developing requirements on the exchange rate an entity uses when the currency is not exchangeable.

17. Alternative B would:

    (a) also result in targeted narrow-scope amendments to IAS 21, but

    (b) result in the development of requirements for exchangeability and a lack of exchangeability, which could apply more generally to a range of circumstances.

18. Such an approach would require the development of requirements on a lack of exchangeability that are sufficiently precise and well-defined so that entities would not inappropriately apply them to other situations.

19. In line with our preliminary view in November 2018, we think the Committee should proceed with Alternative B. This is because:

    (a) the benefits of this alternative would be greater than those derived from Alternative A. This is because Alternative A would address only extreme situations which do not occur frequently. We have been informed that the absence of requirements in IAS 21 on this matter can create problems in several jurisdictions in which entities have no (or restricted) access to foreign currency but the situation is not as extreme as that in Venezuela.

    (b) Alternative B would provide greater clarity on when exchangeability is lacking and, by doing so, would clearly set out the circumstances in which an entity uses an estimated exchange rate.

### *Committee's preliminary views on possible standard-setting*

20. In November 2018, all Committee members who commented on the approach agreed that:

    (a) the Board should undertake standard-setting, and

    (b) Alternative B is the appropriate way forward.

21. Two Committee members said circumstances in which exchangeability is lacking might arise infrequently. However, they said, when those circumstances arise, the situation can deteriorate rapidly and can significantly affect an entity's financial statements. One Committee member said Alternative B would help entities assess and identify when exchangeability is lacking.

## Staff recommendations

22. Based on our analysis in paragraphs 11–21 of this paper, we recommend:

    (a) undertaking narrow-scope standard-setting that does not reconsider the fundamental requirements in IAS 21;

(b) applying the approach described as Alternative B in this paper ie:

  (i) define ‘exchangeability’ and, consequently, a ‘lack of exchangeability’; and

  (ii) specify requirements that would apply when a currency is subject to a lack of exchangeability.

| **Question for the Committee** |
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| Does the Committee agree with our recommendations as set out in paragraph 22 of this agenda paper? |