Staff paper

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Project	**Lack of Exchangeability (Proposed amendments to IAS 21)**
Topic	**Disclosure and transition**
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Purpose of this paper

1. As discussed in Agenda Paper 12 for this meeting, this paper provides our analysis of the main comments received on Questions 3 and 4—disclosure and transition in the Exposure Draft *Lack of Exchangeability* and our recommendations for the International Accounting Standards Board (IASB).
2. Our analysis and recommendations take into account feedback in comment letters.

Structure of this paper

3. This paper includes:
   (a) summary of staff recommendations;
   (b) staff analysis and recommendations related to disclosure and transition; and
   (c) question for the IASB (included after paragraph 22).
4. The Appendix to this paper sets out respondents' other comments on the proposed disclosure requirements.

Summary of recommendations

5. We recommend that the IASB:
   (a) proceed with requiring disclosures as proposed in paragraphs 57A and A16–A18 of the Exposure Draft when an entity estimates the spot exchange rate because exchangeability between two currencies is lacking; and
   (b) proceed with the transition requirements as proposed in paragraphs 60L–60M of the Exposure Draft.

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Staff analysis and recommendations

Disclosure

Proposals in the Exposure Draft

6. Paragraph BC21 of the Basis for Conclusions on the Exposure Draft explains that estimating a spot exchange rate when exchangeability between two currencies is lacking could materially affect an entity's financial statements. That estimation would also require the use of judgements and assumptions. In developing the Exposure Draft, the IASB was informed that users of financial statements (investors) are interested not only in the effect on the financial statements of estimating the spot exchange rate, but in understanding an entity's exposure to a currency that lacks exchangeability. The proposed disclosure requirements were therefore designed to provide investors with such information.

7. The Exposure Draft proposed to amend IAS 21 to add paragraph 57A to require an entity to disclose information that would enable investors to understand how a lack of exchangeability between two currencies affects, or is expected to affect, its financial performance, financial position and cash flows. To achieve this objective, an entity would be required to disclose information about the nature and financial effects of a lack of exchangeability; the spot exchange rate (or rates) used; the estimation process; and the risks to which the entity is exposed because of the lack of exchangeability. Paragraphs A16–A18 of the Exposure Draft specify how an entity applies paragraph 57A.

Respondents' comments

8. Many respondents agreed with the proposed disclosure requirements for the reasons explained while some respondents expressed concerns about those proposed requirements. For example, some respondents requested clarification about the interaction between the proposed disclosure requirements and those in other IFRS Accounting Standards including IAS 1 *Presentation of Financial Statements*, IAS 10 *Events after the Reporting Period*, IFRS 7 *Financial Instruments: Disclosures*, IFRS 12 *Disclosure of Interests in Other Entities* and IFRS 13 *Fair Value Measurement*. We summarise and analyse these comments in the Appendix to this paper.

9. One respondent suggested that an entity be required to disclose significant judgements, and changes in judgements, made in applying IAS 21's requirements when exchangeability is lacking. This respondent said IFRS 15 *Revenue from Contracts with Customers* and IFRS 17 *Insurance Contracts* require an entity to provide similar disclosures in applying those Standards. This respondent also suggested that, when estimating the spot exchange rate, an entity be required to disclose the assumptions and inputs used in its estimation technique.

10. Some respondents requested additional disclosures to supplement those in the Exposure Draft and in existing IFRS Accounting Standards. We summarise and analyse these comments in the Appendix to this paper.

Staff analysis

11. Feedback from respondents suggests that, on balance, the proposed disclosure requirements set out in paragraphs 57A and A16–A18 of the Exposure Draft would result in useful information to enable investors to understand the effects—on financial performance, financial position and cash flows—when an entity estimates the spot exchange rate because exchangeability is lacking. Respondents did not raise significant concerns about the costs of complying with the proposed disclosure requirements.

12. As stated in proposed paragraph A16, an entity need not duplicate information required by paragraphs A17–A18 if it has provided the information elsewhere in its financial statements. Paragraph BC22 of the Basis for Conclusions on the Exposure Draft states, for example, that an entity might already provide some of the information required by the proposals when applying IAS 1, IFRS 7 and IFRS 12. As set out in the Appendix to this paper, we recommend no change in response to comments to (a) provide more specificity about interactions between the proposed disclosure requirements—when an entity estimates the spot exchange rate because exchangeability is lacking—and disclosure requirements in other IFRS Accounting Standards; and (b) require additional disclosures.

13. We considered respondents' comments that an entity be required to disclose significant judgements, and changes in judgements, made in applying IAS 21's requirements when exchangeability is lacking, similar to requirements in IFRS 15 and IFRS 17. Paragraph BC23 of the Basis for Conclusions on the Exposure Draft states that when developing the Exposure Draft, the IASB concluded that it was unnecessary to include specific disclosure requirements regarding significant judgements made in assessing exchangeability; this is because paragraph 122 of IAS 1 would already require disclosure of such judgements to the extent they are part of the judgements management has made that have the most significant effect on the amounts recognised in the financial statements. In our view, this approach remains valid, and we therefore recommend no change to add to IAS 21 a requirement to disclose significant judgements and changes in judgements.

14. We will consider in drafting paragraph A17(e) whether to specify that an entity be required to disclose the assumptions and inputs used in its estimation technique (paragraph A17(e) already proposed to require disclosure of qualitative and quantitative information about the inputs used).

Staff recommendation

15. Based on our analysis, we recommend that the IASB proceed with the disclosure requirements in paragraphs 57A and A16–A18 of the Exposure Draft.

Transition

Proposals in the Exposure Draft

16. The Exposure Draft proposed to amend IAS 21 to require an entity to apply the amendments from the date of initial application and permit earlier application. The IASB proposed no exemption from retrospective application for first-time adopters. Paragraphs BC24–BC27 of the Basis for Conclusions on the Exposure Draft explain the IASB's rationale for the proposed transition requirements.

Respondents' comments

17. Most respondents agreed with the proposed transition requirements for the reasons explained.

18. A few respondents commented on aspects of the proposal. In particular:

    (a) a few respondents asked that the transition requirements specifically refer to particular items, such as deferred tax balances, assets measured at recoverable amounts and non-monetary items measured at fair value when the valuation date does not coincide with the date of initial application;

    (b) one respondent said it is necessary to provide an exemption for first-time adopters because retrospective application would require hindsight and would be costly; and

    (c) one respondent said applying the amendments should have no effect on opening retained earnings because the exchange rate used is based on estimation and may not fully align with different exchange rates in the market.

Staff analysis

19. We are not persuaded by respondents' comments that it is necessary for the IASB to add requirements to explain—on transition—the interaction between the amendments to IAS 21 and other IFRS Accounting Standards. An entity applies judgement in adopting new requirements in IFRS Accounting Standards in the light of its facts and circumstances.

20. In our view, the IASB's reasoning—explained in paragraph BC26 of the Basis for Conclusions on the Exposure Draft—for not adding a specific exemption from retrospective application for first-time adopters remains valid.

21. We disagree with the suggestion that the proposed amendments to IAS 21 be treated as a change in estimate according to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. The amendments would result in a change in accounting policy introduced by IAS 21 (as amended).

Staff recommendation

22. Based on our analysis, we recommend that the IASB proceed with the transition requirements in paragraphs 60L–60M of the Exposure Draft.

Question for the IASB

Does the IASB agree with our recommendations set out in paragraph 5 to:

(a) proceed with requiring disclosures as proposed in paragraphs 57A and A16–A18 of the Exposure Draft when an entity estimates the spot exchange rate because exchangeability between two currencies is lacking; and

(b) proceed with the transition requirements as proposed in paragraphs 60L–60M of the Exposure Draft.

Appendix—Other comments on disclosure requirements

A1. Respondents provided other suggestions that we analyse below:

	Respondents' suggestion	Staff analysis and recommendations
1	Require disclosure similar to sensitivity analysis such as: (a) an analysis of possible changes to the exchange rate for the next 12 months and their effect on the reported statements of financial position and comprehensive income; (b) the potential effect on the financial statements of using different exchange rates (such as official exchange rates, observable exchange rates, exchange rates from parallel markets and estimated spot exchange rates); and (c) quantified differences between the estimated spot exchange rate and any official exchange rates.	We recommend no change. Having considered the feedback, sensitivity analysis disclosures—and disclosures of other exchange rates and differences between estimated and official rates—would add costs for preparers and we are unsure that it would add at least the same benefit for investors beyond that already provided by the information recommended for disclosure.
2	With reference to IAS 10, require disclosure of material changes that occur after the reporting date that may affect the estimated spot exchange rate.	We recommend no change. IAS 10 already requires disclosure of information about non-adjusting events after the reporting period and specifies requirements for adjusting events after the reporting period.
3	Align the proposed disclosure requirements for foreign operations with those for material subsidiaries, joint ventures and associates in IFRS 12; and link the use of estimated exchange rates to the 'levelling disclosure' applying the fair value hierarchy in IFRS 13.	We agree that entities should align disclosures about foreign operations with other disclosure required by IFRS 12. As stated in paragraph A16 of the Exposure Draft, 'an entity need not duplicate information required by paragraphs A17–A18 if it has provided the information elsewhere in its financial statements'. We will consider the need for a possible consequential amendment to the 'levelling disclosure' in IFRS 13.

4	Require disclosure to provide information about judgements made, for example, how an entity determines: (a) what constitutes a normal administrative delay; or (b) what is an 'insignificant amount' of the other currency.	We recommend no change. Paragraph 122 of IAS 1 already requires disclosure of judgements that management has made that have the most significant effect on the amounts recognised in the financial statements. In developing the Exposure Draft, the IASB decided not to include more specific disclosure requirements about significant judgements as part of this project.
5	Require disclosure to provide information about the legal framework that results in a lack of exchangeability and situations in which an entity is unable to access foreign currency on a non-temporary basis (locked-in capital).	In our view, an entity would consider disclosure of that information in applying proposed paragraphs A17(a)–(b), which would require an entity to disclose a description of the restrictions that result in one currency not being exchangeable into another currency and a description of affected transactions.
6	Require disclosure to provide information about the existence of an observable exchange rate and the reason for not using it in estimating the spot exchange rate.	We recommend no change. As discussed in Agenda Paper 12B for this meeting, we recommend that the IASB not require an entity to maximise the use of observable exchange rates as it may be more cost effective for the entity to use another estimated input rate that would result in a rate that meets the objective.
7	Require disclosure to provide information about the changes in, and the amount of, the accumulated translation reserve since lack of exchangeability occurred.	We recommend no change. Having considered the feedback, the requested disclosures would add costs for preparers and we are unsure that they would add at least the same benefit for investors beyond that already provided by the information recommended for disclosure.
8	Require disclosure to provide information about the financial effect and risks in the functional currency and presentation currency.	We recommend no change. The proposed disclosure requirements would apply when an entity estimates a spot exchange rate because exchangeability is lacking, whether that is because the entity—applying IAS 21—reports foreign currency transactions in its functional currency, uses a presentation currency other than its functional currency or translates the results and financial position of a foreign operation.

9	Require disclosure about the effect of using alternative exchange rates, even when there is no lack of exchangeability.	We recommend no change. This matter is outside the scope of the project.
10	Consider whether to extend the proposal to provide information about the hyperinflationary or high inflation environment in which an entity might operate.	We recommend no change. Applying proposed paragraph A17(a), information about the hyperinflationary or high inflation environment as part of its description of the restrictions that result in a currency not being exchangeable. IAS 29 *Financial Reporting in Hyperinflationary Economies* provides requirements for an entity whose functional currency is the currency of a hyperinflationary economy.
11	Specify whether the disclosure requirements would apply if a lack of exchangeability no longer exists at the reporting date but existed during the reporting period.	Proposed paragraph 57A states [emphasis added]: '*When* an entity estimates a spot exchange rate because *exchangeability between two currencies is lacking* …, the entity shall disclose information…' In our view, disclosures would be required not only when exchangeability is lacking at the end of the reporting period, but also when exchangeability is lacking during part of the reporting period even if that is no longer the case at the end of the reporting period.
12	Provide presentation requirements.	We recommend no change. IAS 1 sets out requirements for presentation of financial statements, and IAS 21 provides requirements for presenting the effects of changes in foreign exchange rates. Providing additional presentation requirements is outside the scope of this project.