Issue 220 / September 2023

IFRS Developments

Amendments to IAS 21: Lack of Exchangeability

What you need to know

- The IASB has amended IAS 21 to specify how an entity should assess whether a currency is exchangeable and how it should determine a spot exchange rate when exchangeability is lacking
- The amendments require disclosure of information that enables users of financial statements to understand the impact of a currency not being exchangeable
- The amendments apply to annual reporting periods beginning on or after 1 January 2025 and can be applied earlier. However, an entity cannot restate comparative information

Background

On 15 August 2023, the International Accounting Standards Board (the IASB or Board) issued *Lack of Exchangeability* (Amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates*) (the amendments).

IAS 21 sets out the requirements for determining the exchange rate to be used for recording a foreign currency transaction into the functional currency and translating a foreign operation into a different currency. If a currency lacks exchangeability, it can be difficult to determine an appropriate exchange rate to use. While relatively uncommon, a lack of exchangeability might arise when a government imposes foreign exchange controls that prohibit the exchange of a currency or that limit the volume of foreign currency transactions.

Amendments to IAS 21

The amendments clarify how an entity should assess whether a currency is exchangeable and how it should determine a spot exchange rate when exchangeability is lacking, as well as require the disclosure of information that enables users of financial statements to understand the impact of a currency not being exchangeable.

Assessing whether a currency is exchangeable

Under the amendments, a currency is considered to be exchangeable into another currency when an entity is able to obtain the other currency within a time frame that allows for a normal administrative delay and through a market or exchange mechanism in which an exchange transaction would create enforceable rights and obligations. An exchange transaction might not always complete instantaneously because of legal or regulatory requirements, or for practical reasons such as public holidays, but such a normal administrative delays do not preclude a currency from being exchangeable into the other currency.

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An entity assesses whether a currency is exchangeable into another currency at a measurement date and for a specified purpose. In making that assessment, an entity must consider its ability to obtain the other currency, rather than its intention or decision to do so. A currency is not exchangeable into the other currency if the entity is able to obtain no more than an insignificant amount of the other currency at the measurement date for the specified purposes. Furthermore, in making the assessment, an entity only considers markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations, meaning that so-called unofficial, parallel or black markets would not be considered. Enforceability is a matter of law and depends on facts and circumstances.

The amendments note that different exchange rates might be available for different uses of a currency (e.g., imports of specific goods and distribution of dividends). Therefore, an entity is required to assess whether a currency is exchangeable into another currency separately for each particular purpose.

If a currency is not exchangeable into another currency, an entity is required to estimate the spot exchange rate at the measurement date.

Estimating the spot exchange rate when a currency is not exchangeable

If a currency is not exchangeable into another currency, an entity is required to estimate the spot exchange rate at the measurement date. An entity's objective in estimating the spot exchange rate is to reflect the rate at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic conditions.

The amendments do not specify how an entity estimates the spot exchange rate to meet the objective, but they note that an entity can use an observable exchange rate without adjustment or another estimation technique.

Examples of observable exchange rates include:

- A spot exchange rate for a purpose other than that for which an entity assesses exchangeability – in assessing whether such a rate meets the objective above, an entity is required to consider factors such as: a) whether several observable exchange rates exist; b) the purpose for which the currency is exchangeable; c) the nature of the exchange rate; and d) the frequency with which exchange rates are updated.
- The first subsequent exchange rate at which an entity is able to obtain the other currency for the specified purpose after exchangeability is restored – in assessing whether such a rate meets the objective above, an entity is required to consider factors such as: a) the time between the measurement date and the date at which exchangeability is restored; and b) inflation rates.

If an entity uses another estimation technique, it may use any observable exchange rate – including rates from exchange transactions in markets or exchange mechanisms that do not create enforceable rights and obligations – and adjust that rate, as necessary, to meet the objective above.

Consequential amendments

The requirement in paragraph 26 of IAS 21 states that 'if exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made', has now been removed and the new guidance described above should be applied instead. In addition, certain consequential amendments are made to the guidance in IFRS 1 *First-time Adoption of International Financial Reporting Standards* regarding severe hyperinflation.

Disclosure requirements

When an entity estimates a spot exchange rate because a currency is not exchangeable into another currency, it discloses information that enables users of its financial statements to understand how the currency not being exchangeable into the other currency affects, or is expected to affect, the entity's financial performance, financial position and cash flows. To meet this objective, an entity is required to disclose information about:

- The nature and financial effects of the currency not being exchangeable into the other currency
- The spot exchange rate(s) used
- The estimation process, and
- The risks to which the entity is exposed because of the currency not being exchangeable into the other currency

An entity is required to consider how much detail is necessary to satisfy the above disclosure objective. In addition, the amendments specifically require an entity to disclose:

- The currency and a description of the restrictions that result in that currency not being exchangeable into the other currency
- A description of affected transactions
- The carrying amount of affected assets and liabilities
- The spot exchange rates used and whether those rates are observable exchange rates without adjustment or spot exchange rates estimated using another estimation technique
- A description of any estimation technique the entity has used, and qualitative and quantitative information about the inputs and assumptions used in that estimation technique
- Qualitative information about each type of risk to which the entity is exposed because the currency is not exchangeable into the other currency, and the nature and carrying amount of assets and liabilities exposed to each type of risk

When a foreign operation's functional currency is not exchangeable into the presentation currency or, if applicable, the presentation currency is not exchangeable into a foreign operation's functional currency, an entity is also required to disclose:

- The name of the foreign operation; whether the foreign operation is a subsidiary, joint operation, joint venture, associate or branch; and its principal place of business
- Summarised financial information about the foreign operation
- The nature and terms of any contractual arrangements that could require the entity to provide financial support to the foreign operation, including events or circumstances that could expose the entity to a loss

Effective date and transition

The amendments apply for annual reporting periods beginning on or after 1 January 2025. Earlier application is permitted, in which case, an entity is required to disclose that fact. The date of initial application is the beginning of the annual reporting period in which an entity first applies the amendments. When applying the amendments, an entity cannot restate comparative information, instead:

- When the entity reports foreign currency transactions in its functional currency, and, at the date of initial application, concludes that its functional currency is not exchangeable into the foreign currency or, if applicable, concludes that the foreign currency is not exchangeable into its functional currency, the entity is required at the date to:
  - Translate affected foreign currency monetary items, and non-monetary items measured at fair value in a foreign currency, using the estimated spot exchange rate at that date
  - Recognise any effect of initially applying the amendments as an adjustment to the opening balance of retained earnings
- When the entity uses a presentation currency other than its functional currency, or translates the results and financial position of a foreign operation, and, at the date of initial application, concludes that its functional currency (or the foreign operation's functional currency) is not exchangeable into its presentation currency or, if applicable, concludes that its presentation currency is not exchangeable into its functional currency (or the foreign operation's functional currency), the entity is required at the date of initial application to:
  - Translate affected assets and liabilities using the estimated spot exchange rate at that date
  - Translate affected equity items using the estimated spot exchange rate at that date if the entity's functional currency is hyperinflationary, and
  - Recognise any effect of initially applying the amendments as an adjustment to the cumulative amount of translation differences – accumulated in a separate component of equity

How we see it

A lack of exchangeability might arise when a government imposes currency controls in response to macro-economic instability and balance-of-payments problems. In addition, the currencies of hyperinflationary economies often experience a lack of exchangeability. The amendments provide helpful guidance on accounting for a lack of exchangeability and are expected to reduce the existing diversity in practice.

The application of the amendments requires a significant degree of judgement and a good understanding of the facts and circumstances regarding the currencies that suffer from a lack of exchangeability. In addition, the amendments introduce detailed new disclosure requirements. Therefore, it is important for entities to start evaluating the potential impact of these amendments in a timely manner.

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EYG No. 008283-23Gbl
ED None

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