



iGAAP in Focus

Financial reporting

IASB amends IAS 21 to clarify when a currency is exchangeable and how to determine the exchange rate when it is not

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This iGAAP in Focus outlines the amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates* titled *Lack of Exchangeability*, published by the International Accounting Standards Board (IASB) in August 2023.

- The IASB has published amendments to IAS 21 that specify how to assess whether a currency is exchangeable and how to determine the exchange rate when it is not
- Applying the amendments, a currency is exchangeable when an entity is able to exchange that currency for the other currency through market or exchange mechanisms that create enforceable rights and obligations without undue delay at the measurement date and for a specified purpose. However, a currency is not exchangeable into the other currency if an entity can only obtain no more than an insignificant amount of the other currency at the measurement date for the specified purpose
- When a currency is not exchangeable at the measurement date, an entity is required to estimate the spot exchange rate as the rate that would have applied to an orderly exchange transaction at the measurement date between market participants under prevailing economic conditions. In that case, an entity is required to disclose information that enables users of its financial statements to evaluate how the currency's lack of exchangeability affects, or is expected to affect, the entity's financial performance, financial position and cash flows
- Entities are required to apply the amendments for annual reporting periods beginning on or after 1 January 2025 with earlier application permitted. An entity is not permitted to apply the amendments retrospectively. Instead, an entity is required to apply the specific transition provisions included in the amendments

For more information please see the following websites:

www.iasplus.com

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Background

The IFRS Interpretations Committee (IFRS IC) received a submission about the determination of the exchange rate when there is a long-term lack of exchangeability. The IFRS IC considered different approaches to address the matter and concluded that the best way forward was to recommend that the IASB publishes narrow-scope amendments to IAS 21.

The amendments

Definition of 'exchangeable'

The amendments state that a currency is 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 entity assesses whether a currency is exchangeable into another currency at a measurement date and for a specified purpose. If an entity is able to obtain no more than an insignificant amount of the other currency at the measurement date for the specified purpose, the currency is not exchangeable into the other currency.

The assessment of whether a currency is exchangeable into another currency depends on an entity's ability to obtain the other currency and not on its intention or decision to do so.

Estimating the spot exchange rate when a currency is not exchangeable

When a currency is not exchangeable into another currency at a measurement date, an entity is required to estimate the spot exchange rate at that 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 that objective. An entity can use an observable exchange rate without adjustment or another estimation technique. Examples of an observable exchange rate include:

- A spot exchange rate for a purpose other than that for which an entity assesses exchangeability
- The first exchange rate at which an entity is able to obtain the other currency for the specified purpose after exchangeability of the currency is restored (first subsequent exchange rate)

An entity using another estimation technique 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 as set out above.

Observation

The IASB decided not to provide any detailed requirements on how an entity estimates a spot exchange rate because estimating a spot exchange rate can be complicated and depends on entity-specific and jurisdiction-specific facts and circumstances. Accordingly, prescribing how to estimate a spot exchange rate is unlikely to capture all relevant factors for all possible situations without being overly burdensome. In addition, the requirements for assessing exchangeability are expected to result in an entity estimating the spot exchange rate only in a narrow set of circumstances.

Disclosure requirements when an entity estimates the spot exchange rate

When an entity estimates a spot exchange rate because a currency is not exchangeable into another currency, the entity is required to disclose 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 achieve 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
- The risks to which the entity is exposed because of the currency not being exchangeable into the other currency

In particular, an entity is required 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 vice versa, if applicable), 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

Accompanying documents and consequential amendments

The amendments add a new appendix as an integral part of IAS 21. The appendix includes application guidance on the requirements introduced by the amendments. The amendments also add new *Illustrative Examples accompanying IAS 21*, which illustrate how an entity might apply some of the requirements in hypothetical situations based on the limited facts presented.

In addition, the IASB made consequential amendments to IFRS 1 *First-time Adoption of International Financial Reporting Standards* to align with and refer to the revised IAS 21 for assessing exchangeability.

Effective date and transition

An entity is required to apply the amendments for annual reporting periods beginning on or after 1 January 2025. Earlier application is permitted. If an entity applies the amendments for an earlier period, it is required to disclose that fact.

In applying the amendments, an entity is not permitted to restate comparative information. Instead:

- When the entity reports foreign currency transactions in its functional currency, and, at the date of initial application (which is the beginning of the annual reporting period in which the entity first applies the amendments), concludes that its functional currency is not exchangeable into the foreign currency or, if applicable, the foreign currency is not exchangeable into its functional currency, the entity is required at that 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, its presentation currency is not exchangeable into its functional currency (or the foreign operation's functional currency), the entity is required at that date 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
 - 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

Further information

If you have any questions about the amendments to IAS 21, please speak to your usual Deloitte contact or get in touch with a contact identified in this *iGAAP in Focus*.

The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosures literature. **iGAAP on DART** allows access to the full IFRS Standards, linking to and from:

- Deloitte's authoritative up-to-date iGAAP manual which provides guidance for reporting under IFRS Standards
- Model financial statements for entities reporting under IFRS Accounting Standards

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