# IAS 21 The Effects of Changes in Foreign Exchange Rates — Basis for Conclusions (Abridged)

*This Basis for Conclusions accompanies, but is not part of,* IAS 21.

*Following are the paragraphs from the IASB's Basis for Conclusions on* IAS 21 *necessary to understand the amendments for Lack of Exchangeability (Amendments to IAS 21), issued by the IASB in August 2023 and amendments for IFRS 18 Presentation and Disclosure in the Financial Statements issued by the IASB in April 2024.*

## Lack of Exchangeability

### Background to the August 2023 amendments

BC41 In August 2023 the IASB issued *Lack of Exchangeability* and amended the Standard to improve the usefulness of information provided to users of financial statements. The amendments require entities to apply a consistent approach to determining whether a currency is exchangeable into another currency and the spot exchange rate to use when it is not. The IASB had been informed of diverse views among stakeholders on how to determine whether a currency is exchangeable into another currency and the exchange rate to use when it is not. Although circumstances in which a currency is not exchangeable into another currency might arise relatively infrequently, when they do arise, economic conditions can deteriorate rapidly. In those circumstances, the diverse views on the application of the Standard could have led to material differences in affected entities' financial statements. In developing the amendments, the IASB considered input from the IFRS Interpretations Committee and feedback from stakeholders on the IASB's April 2021 Exposure Draft *Lack of Exchangeability*.

### Assessing whether a currency is exchangeable

BC42 Many factors influence the exchangeability of one currency into another currency. To make the definition of 'exchangeable' operational and to help entities apply that definition consistently, the Standard specifies when an entity is able to exchange a currency for another currency. In developing the definition and related application guidance, the IASB discussed the following questions:

(a) what time frame for obtaining the other currency does an entity consider (see paragraphs BC43–BC44)?

(b) what if an entity is able to obtain the other currency, but does not intend to do so (see paragraph BC45)?

(c) which markets or exchange mechanisms for obtaining the other currency does an entity consider (see paragraph BC46)?

(d) what is the purpose for which an entity obtains the other currency (see paragraphs BC47–BC50)?

(e) what if an entity is able to obtain only limited amounts of the other currency (see paragraphs BC51–BC52)?

#### Time frame

BC43 The IASB concluded that a normal administrative delay in obtaining the other currency:

(a) does not contradict the notion of 'immediate delivery' in the definition of a spot exchange rate in paragraph 8 of the Standard. In the IASB's view, the notion of 'immediate delivery' incorporates a short period of time to meet administrative, legal or regulatory requirements in exchanging currencies.

(b) does not preclude a currency from being exchangeable into that other currency. In the IASB's view, acknowledging the existence of normal administrative delays in currency exchanges improves the operability of the requirements. If an entity cannot consider a normal administrative delay in its assessment of the time frame to exchange one currency for another, the entity might inappropriately conclude that a currency is not exchangeable into another currency.

BC44 The IASB decided not to develop application guidance on what constitutes a 'normal administrative delay'—this assessment would depend on facts and circumstances.

#### Ability to obtain the other currency

BC45 The IASB decided that assessing 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. For example, a currency can be exchangeable into another currency for the purpose of realising an entity's net investment in a foreign operation even if the entity has no intention of entering into a transaction that would result in realising that net investment. This requirement is consistent with other requirements in the Standard—for example, the requirement to use a spot exchange rate when translating amounts into another currency, regardless of an entity's intention or decision to enter into a transaction at that spot exchange rate.

**Markets or exchange mechanisms**

BC46 The IASB observed that the nature and type of markets or exchange mechanisms can vary between jurisdictions. The IASB discussed whether to require an entity to consider specified markets or exchange mechanisms (for example, government-administered exchange mechanisms) when assessing exchangeability. The IASB decided that, when assessing whether a currency is exchangeable into another currency, entities consider only markets or exchange mechanisms in which a transaction to exchange that currency into the other currency would create enforceable rights and obligations.

**Purpose of obtaining the other currency**

BC47 In many jurisdictions (particularly those in which exchange rates are free-floating), only one exchange rate exists between two currencies. In such jurisdictions, the purpose for which an entity intends to use the other currency would neither change the exchange rate nor affect the entity's ability to obtain that other currency. However, for some currencies, different exchange rates might apply for different uses, which could affect an entity's ability to obtain those currencies. The IASB therefore concluded that it is important for an entity to consider the purpose for which it obtains the other currency.

BC48 The IASB considered, separately, situations in which an entity:

(a) reports foreign currency transactions in its functional currency (see paragraph BC49); and

(b) uses a presentation currency other than its functional currency or translates the results and financial position of a foreign operation (see paragraph BC50).

BC49 Paragraphs 20–37 of the Standard specify requirements for reporting foreign currency transactions in the functional currency. These requirements apply to individual foreign currency transactions, and monetary and non-monetary items relating to such transactions. The IASB decided that, when reporting foreign currency transactions, an entity assesses a currency's exchangeability separately for each individual transaction, asset or liability—that is, an entity would assume the purpose of obtaining foreign currency is to realise or settle the individual foreign currency transaction, or an asset or liability related to that transaction. An entity would therefore assess whether it is able to obtain the other currency to realise or settle the transaction, or the asset or liability related to that transaction. Requiring entities to assess each individual transaction, asset or liability does not create a new assessment, because paragraph 26 of the Standard requires an entity to do so when several exchange rates are available.

BC50 Paragraphs 38–49 of the Standard specify requirements for the use of a presentation currency other than the functional currency and for translating the results and financial position of a foreign operation. These requirements apply to all assets and liabilities (that is, the net assets or net liabilities)—and not to individual assets or liabilities—of an entity or its foreign operation. The IASB therefore decided that, in these situations, an entity assesses exchangeability from the perspective of a transaction that would result in realising or settling its net assets or net liabilities (or net investment in the foreign operation). The IASB observed that:

(a) entities in some jurisdictions might experience a delay in remitting dividends, and such a delay would not necessarily result in an entity concluding that a currency is not exchangeable into the other currency; such a delay might reflect a normal administrative delay. Also, an entity concluding that a currency is not exchangeable into another currency does not automatically require the entity to use a complex estimation technique (see paragraph BC55).

(b) an entity considers its ability to realise its net assets (or net investment in a foreign operation) in a single transaction—and not over time—even though an entity might often be unable to realise its net assets in a single transaction. This consideration is consistent with other requirements in the Standard (see paragraph BC49). In accordance with paragraph A10 of the Standard, a currency would be exchangeable into another currency even if an entity is unable to obtain the entire amount—but is able to obtain more than an insignificant amount—of the other currency required to realise its net assets or net investment in a foreign operation (see paragraphs BC51–BC52).

**Ability to obtain only limited amounts of the other currency**

BC51 An entity might be able to obtain only limited amounts of the other currency. The IASB decided to specify that, in such circumstances, a currency is exchangeable into another currency when an entity is able to obtain more than an insignificant amount of that other currency. This approach is similar to the approach in IFRS 13 *Fair Value Measurement* when the volume or level of activity for an asset or liability has significantly decreased (see paragraphs B37–B42 of IFRS 13), in which case an entity may depart from using unadjusted observable prices. Similarly, when the activity in the market in which an entity obtains the other currency is so low that the entity is able to obtain no more than an insignificant amount of that other currency, the entity estimates the spot exchange rate applying paragraph 19A of the Standard—in which case the entity may depart from using the observable exchange rate.

BC52 In developing the requirements, the IASB considered the level at which an entity assesses the significance of the amount of the other currency it is able to obtain—for example, whether an entity performs this assessment for each transaction and balance separately, or on an aggregated basis. The IASB decided that an entity assesses the significance of the amount of the other currency it is able to obtain for a specified purpose using the aggregate method described in paragraph A10 of the Standard. Instead of requiring an entity to consider each transaction or balance separately, the aggregate method requires an entity to compare the amount of the other currency it is able to obtain with the aggregated amount (the sum) of the transactions or balances it needs to recover or settle.

## Estimating the spot exchange rate when a currency is not exchangeable

BC53 The IASB decided that when one currency is not exchangeable into another currency at a measurement date, an entity estimates the spot exchange rate at that date. The objective in paragraph 19A of the Standard is for an entity to estimate the rate at which an orderly exchange transaction hypothetically would take place at the measurement date between market participants under prevailing economic conditions. This approach is similar to (although not the same as) an entity measuring an asset or liability at fair value by estimating the price at which an orderly transaction to sell the asset or transfer the liability hypothetically would take place at the measurement date.

BC54 The IASB decided not to provide any detailed requirements on how an entity estimates a spot exchange rate because:

(a) estimating a spot exchange rate can be complicated and depends on entity-specific and jurisdiction-specific facts and circumstances.

(b) the economic models an entity might use to estimate a spot exchange rate are varied. These models vary in complexity and in the economic factors they use as inputs (for example, inflation, interest rates, the balance of payments or a jurisdiction's productivity). The IASB decided not to prescribe one particular estimation technique or approach because that technique or approach would be unlikely to capture all relevant factors for all possible situations without being overly burdensome.

(c) the requirements for assessing exchangeability are expected to result in an entity estimating the spot exchange rate only in a narrow set of circumstances.

(d) the uncertainties inherent in estimating a spot exchange rate are similar to those that relate to other financial information based on estimates. An entity is required to disclose relevant information about the estimated spot exchange rate and the estimation technique (see paragraphs BC58–BC62).

(e) such an approach is consistent with the measurement requirements in other IFRS Accounting Standards. For example, IFRS 9 *Financial Instruments* does not specify a particular technique for the measurement of expected credit losses, but instead sets out an objective.

BC55 The IASB noted that when a currency is not exchangeable into another currency, an entity would not necessarily need to use a complex estimation technique. To reduce complexity, the IASB decided to:

(a) specify that an entity may use an observable exchange rate without adjustment as the estimated spot exchange rate, if that observable exchange rate meets the objective in paragraph 19A of the Standard (see paragraph A12 of the Standard).

(b) include two examples of observable exchange rates that an entity could consider and set out a non-exhaustive list of factors to help entities assess whether those observable exchange rates would meet the objective in paragraph 19A of the Standard (see paragraphs A13–A16 of the Standard).

(c) specify that an entity using another estimation technique could, for example, start with an observable exchange rate—including a rate from an exchange transaction in a market or exchange mechanism that does not create enforceable rights and obligations—and adjust that rate, as necessary, to estimate the spot exchange rate as required by paragraph 19A of the Standard (see paragraph A17 of the Standard).

### Other considerations

BC56 The IASB decided not to specify a hierarchy of observable exchange rates to use in estimating a spot exchange rate because doing so might impose costs without providing more useful information. For example, a hierarchy of observable exchange rates would require an entity to look for, and successively consider, each exchange rate in the hierarchy, when it might be more cost-effective for the entity to use another estimation technique.

BC57 When an entity is able to obtain only limited amounts of the other currency, the IASB considered whether to permit or require the entity to use a blended exchange rate (that is, a weighted average exchange rate reflecting both the rate at which the entity could obtain the other currency for a portion of the transaction or balance and an estimated exchange rate for the remaining portion). The IASB decided not to permit or require the use of such a rate because:

(a) determining a blended exchange rate could be difficult for an entity, thereby increasing costs for preparers without providing significant additional benefits.

(b) in determining a blended exchange rate, an entity would use the observable spot exchange rate only for an insignificant portion of the transaction or balance, and the estimated spot exchange rate for the remaining portion. The entity would do so because, applying the requirements in paragraph A10 of the Standard, the entity would conclude that a currency is not exchangeable into the other currency only when the entity is able to obtain no more than an insignificant amount of the other currency. Therefore, in most cases, the IASB expected that a blended exchange rate will not differ significantly from the estimated spot exchange rate.

## Disclosure

BC58 An entity's estimation of a spot exchange rate when a currency is not exchangeable into another currency could materially affect its financial statements. That estimation would also require the entity to make judgements and assumptions. In developing the requirements, the IASB was informed that users of financial statements are interested not only in the effect on an entity's financial statements of estimating the spot exchange rate, but also in understanding an entity's exposure to a currency that is not exchangeable into another currency. Users said information about the nature and financial effects of a currency not being exchangeable into another currency, the spot exchange rate used, the estimation process and the risks to which the entity is exposed would help their analyses. Accordingly, the applicable disclosure requirements in the Standard are designed to provide users with such information.

BC59 The IASB observed that some of the requirements in paragraphs A19–A20 of the Standard are similar to those in other IFRS Accounting Standards. An entity might already provide some of the information those paragraphs require when applying other Standards. For example, an entity might already provide:

(a) summarised financial information about a foreign operation, in accordance with paragraphs B10 or B12–B13 of IFRS 12 *Disclosure of Interests in Other Entities*;

(b) information about the methodology used to estimate the spot exchange rate, in accordance with paragraphs 125–133 of IAS 1 *Presentation of Financial Statements*; * and

(c) some (or all) of the qualitative and quantitative information about the nature and extent of risks arising from a currency that is not exchangeable into another currency, in accordance with the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* and IFRS 12.

BC60 Nonetheless, the IASB concluded it would be helpful to include the requirements in paragraphs A19–A20 of the Standard. The IASB observed that an entity need not duplicate information required by the Standard if it has provided the information in its financial statements by applying other disclosure requirements.

BC61 The IASB concluded that it was unnecessary to include specific disclosure requirements regarding significant judgements made in assessing exchangeability. Paragraph 122 of IAS 1 * already requires disclosure of such judgements to the extent they are part of the judgements an entity's management has made that have the most significant effect on the amounts recognised in the financial statements.

BC62 The IASB noted that, for an entity applying paragraph 57A of the Standard, disclosures are required when a currency is not exchangeable into another currency at the end of the reporting period and also when a currency is not exchangeable into another currency during part of the reporting period—even if that is no longer the case at the end of the reporting period.

## Transition

### Entities already applying IFRS Accounting Standards

BC63 The IASB developed the transition requirements in paragraphs 60L–60M of the Standard because it concluded that the expected benefits of requiring entities to apply the amendments retrospectively, in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, * would not outweigh the costs. In particular:

(a) applying the amendments retrospectively would require an entity to assess exchangeability in prior periods and then estimate spot exchange rates for those prior periods. In many cases, retrospective application would be likely to require the use of hindsight and, even if possible without hindsight, would be costly.

(b) a currency not being exchangeable into another currency is generally accompanied by high inflation and other economic events that make trend information less useful for investors than in other situations. The IASB was informed that, when a currency is not exchangeable into another currency, users of financial statements are interested in understanding an entity's exposure at the reporting date to that currency. The IASB therefore concluded that an entity applies the amendments from the date of initial application without restating comparative information.

BC64 The IASB decided:

(a) to require an entity to translate items using the estimated spot exchange rate at the date of initial application if the related requirement in the Standard requires an entity to translate that item using the closing rate.

(b) not to permit an entity to retranslate other items, even though they might have been translated using a spot exchange rate that is not aligned with the amendments. The expected benefits of requiring an entity to identify those items and then estimate an appropriate exchange rate would not outweigh the costs.

(c) to require an entity to recognise any effect of initially applying the amendments as an adjustment to:

  (i) the opening balance of retained earnings when the entity reports foreign currency transactions. For these transactions, an entity generally recognises exchange differences in profit or loss. Requiring entities to track separately any exchange differences recognised in other comprehensive income would introduce unnecessary complexity.

(ii) the cumulative amount of translation differences in equity when the entity uses a presentation currency other than its functional currency, or translates the results and financial position of a foreign operation. In these situations, an entity generally recognises exchange differences in other comprehensive income and accumulates those differences in a separate component of equity.

**First-time adopters**

BC65 The IASB concluded that a specific exemption from retrospective application of the amendments would be unnecessary for a first-time adopter because:

(a) IFRS 1 does not provide any exemption for a first-time adopter that reports foreign currency transactions in its financial statements. The entity therefore applies all the applicable requirements in IAS 21 retrospectively when reporting foreign currency transactions.

(b) paragraph D13 of IFRS 1 already allows a first-time adopter to deem the cumulative translation differences for all foreign operations to be zero at its date of transition to IFRS Accounting Standards.

# Footnotes

* When it issued IFRS 18, the IASB carried over paragraphs 125-133 of IAS 1 to paragraphs 31A-31I of IAS 8 *Basis of Preparation of Financial Statements*.

* When it issued IFRS 18, the IASB carried over paragraph 122 of IAS 1 to paragraph 27G of IAS 8.

* When it issued IFRS 18, the IASB changed the title of IAS 8.