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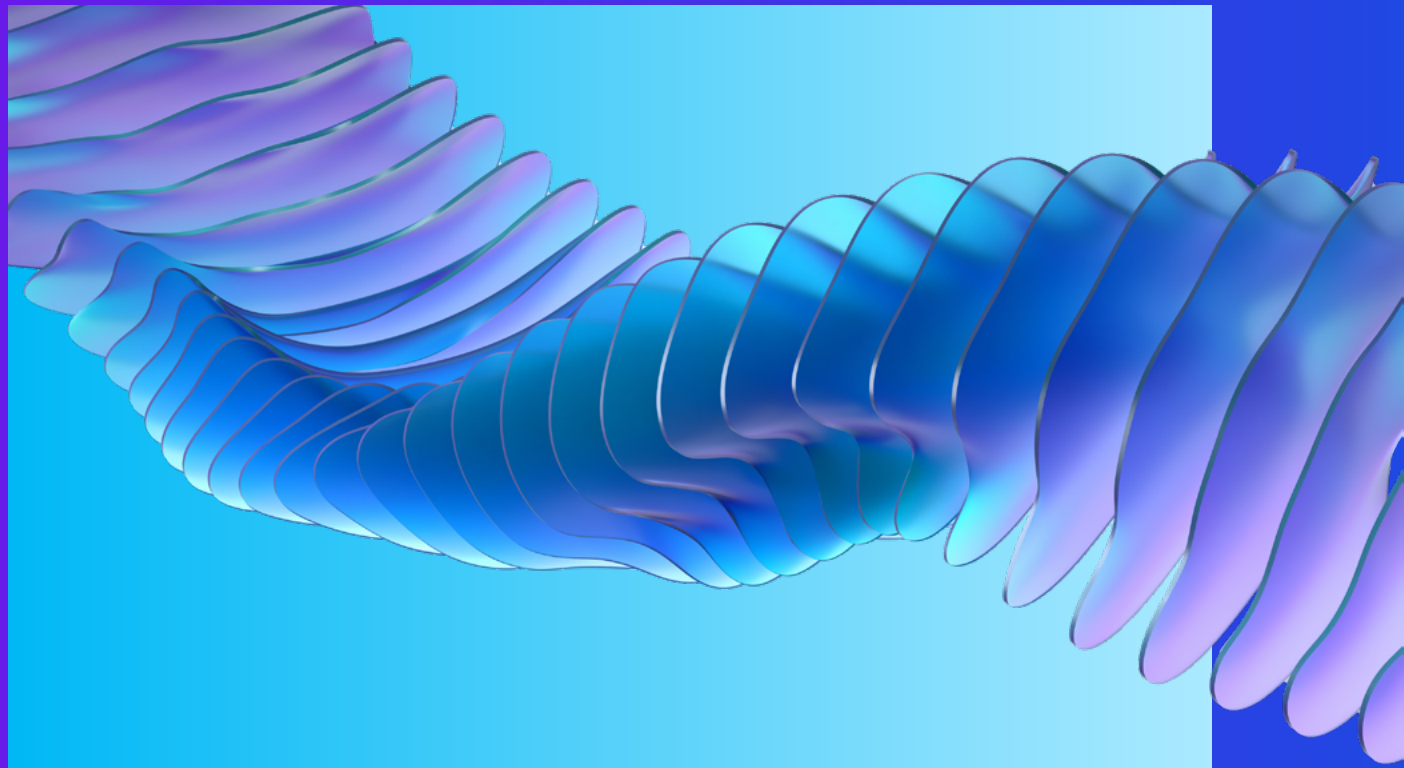

Amendments to the foreign exchange standard

KPMG Argentina

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Amendments to the foreign exchange standard

IAS 21 – The Effects of Changes in Foreign Exchange Rates defines 'foreign currency' as any currency other than the entity's functional currency.

It should be noted that, in general, the entity's functional currency is the legal tender of the primary economic environment in which the entity operates, by which, in our country, it is deemed to be the Argentine peso (ARS). However, there are situations in which the entity may conclude that, based on the parameters of IAS 21, its functional currency is other than the legal tender of its country. Accordingly, most of the Argentine entities have defined the ARS as their functional currency, except for those which concluded that their functional currency is other than the ARS, considering their operations and specific circumstances.

IAS 21 is applicable to:

1. Transactions in foreign currency	For instance, it is applicable to imports and exports, borrowing or lending in foreign currency. The standard establishes the initial recognition of these transactions as well as subsequent measurement of the resulting monetary assets and liabilities.
2. Translation into the reporting entity's functional currency applicable to its foreign operations	It applies when the entity has investments in entities or branches abroad and it needs to include in its financial statements the information about subsidiaries, branches, associates or joint arrangements prepared in their related functional currencies.
3. Translation from the entity's functional currency into the entity's presentation currency of: • Its financial statements • Reporting package for consolidation by the parent company	It is applicable where the entity's functional currency is other than the ARS (for instance, the U.S. dollar (USD)) and the entity, pursuant to legal and regulatory requirements, shall present its financial statements in ARS. It is also applicable where the entity's functional currency is the ARS and the entity prepares information in another currency (for instance, USD or euro) for consolidation purposes by the parent company abroad.

For all these cases, IAS 21 requires that a "spot exchange rate" be used. But what happens when there is no spot exchange rate (or the entity has no access thereto)?

IAS 21 provides the guidelines for the case two currencies are *temporarily* not exchangeable, that is, when for a short period there is no spot exchange rate, or the entity has no access thereto. However, there are no guidelines for a long-term lack of exchangeability.

On August 15, 2023, the International Accounting Standards Board (IASB) issued the amendments to IAS 21 named "Lack of Exchangeability" to provide the guidelines applicable to this case. The amendment requires that the entities should apply a consistent approach to the assessment of whether the currency is exchangeable, and if it is not, they should assess the exchange rate applicable for the measurement purposes defined in the abovementioned points 1. to 3. and the disclosures needed in their financial statements.

Although the IASB stated that the amendment was mainly aimed at resolving investors' questions about the exchange rate to be used to measure their investments in Venezuela (entities with foreign operations in Venezuela did not have a spot exchange rate available), it may have a significant impact on our country, considering the current shortage of foreign currency and the related restrictions.

Until now, for the purposes of applying IAS 21, the official U.S. dollar (USD) exchange rate arising from the Argentine Foreign Exchange Market (MULC) has been used, but the amendment requires rethinking whether the exchange rate from the MULC is the most appropriate in the circumstances of each entity.

Amendment effective date

The amendment to IAS 21 is effective for fiscal years beginning on or after January 1, 2025, and its early application is permitted.

However, on August 15, 2023, the Argentine Securities and Exchange Commission (Comisión Nacional de Valores) issued General Resolution 972/23, which does not allow early application of new IFRS or their amendments.

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Different USD exchange rates

Currently, in Argentina, foreign exchange and stock market regulations allow entities to access foreign currency through different markets or through exchange mechanisms, and the exchange rate may vary substantially from one market to another. The speed of the changes in the regulations makes necessary to analyze them on an ongoing basis.

Briefly, at present, we may say that there are:

Official markets	MULC is the market in which operate entities authorized by the Argentine Central Bank. This market reports two exchange rates: • "Wholesale USD", which is only used for transactions of significant amounts, between banks, foreign trade agents and authorized exchange houses. There is only one exchange rate. • "Retail USD", also known as "official USD" or "import USD" which is the benchmark exchange rate. There are two types of exchange rates: buying and selling. This is the USD exchange rate at which companies purchase foreign currency from the banks for the payment of imports and at which they sell the foreign currency to settle exports. "Banco Nación USD" is the retail USD exchange rate offered by Banco de la Nación Argentina for official transactions in foreign currency and, traditionally, it is the benchmark exchange rate in the foreign exchange market.
Special exchange rates for specific sectors and for given periods	In order to strengthen international reserves, the national government implemented special exchange rates (above the official USD exchange rate) to promote the settlement of exports: • "soybean dollar", a special exchange rate of ARS 300 per UDS, to promote the settlement of soybean exports (ended on May 31, 2023). • "Agribusiness dollar", a special exchange rate of ARS 340 per USD until August 30, 2023 (discontinued on August 14, 2023) for regional economy producers.
Financial markets	Certain exchange mechanisms are currently available through securities traded in the stock markets denominated in ARS and USD. The "exchange rates" of financial dollars are determined by considering the amount of ARS-paid and UDS-received ratio (blue-chip rates): • "Dólar contado con liquidación (CCL dollar)", which is determined when an entity buys in Argentina in ARS a security that is also traded in the United States. Then, a financial institution transfers the security to the holder's account abroad, where the security is sold, and the proceeds are deposited in such account abroad. • "Dólar mercado electrónico de pagos (MEP dollar)", also known as "dólar bolsa", which arises from the purchase by an entity of a security in ARS in the local market that is traded either in ARS or USD. The security is then sold locally in USD, which are deposited in accounts held in the country.
Other transactions	In addition, there is a number of additional taxes or withholdings levied on various foreign currency purchase transactions (particularly those made by individuals) that are based on "Banco Nación dollar" to determine, for example, the "savings USD" or "solidarity USD", "foreign services USD", etc.

Finally, there is an unofficial market known as "blue dollar", which is not a legal market. Transactions are in cash, between parties not authorized to operate in foreign exchange markets and no transaction receipts are issued.

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Amendments to IAS 21

The amendment requires that the entity assesses whether a currency is exchangeable into another currency (Step 1) and if it is concluded that there is no exchangeability, then, the entity needs to estimate the spot exchange rate (Step 2).

Step 1

Assessing whether a currency is exchangeable into another currency

When is currency exchangeable into another?

The amendment defines that a currency is exchangeable into another currency when an entity is able to obtain the other currency:

- within a timeframe 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.

What is meant by "within a timeframe"?

Paragraph 8 of IAS 21 defines a "spot exchange rate" as *"the exchange rate for immediate delivery".*

When there are delays in the delivery of the currency related to compliance with legal or regulatory requirements (normal administrative delay), the amendment clarifies that the exchange rate may be considered as a "spot rate".

But the meaning of "normal administrative delay" is a matter of judgment. The amendment does not include additional guidelines because it is understood that the definition of this matter depends on facts and circumstances of the entity and its environment.

What is meant by "exchange mechanism"?

The amendment does not provide a definition of "exchange mechanism" but it includes transactions in which the currency exchange creates enforceable rights and obligations:

"In assessing whether a currency is exchangeable into another currency, an entity shall consider only markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations. Enforceability is a matter of law. Whether an exchange transaction in a market or exchange mechanism would create enforceable rights and obligations depends on facts and circumstances".

We understand that the concept of exchange mechanism includes the purchase and sale of foreign currency through securities (the so-called "financial dollars"), since it creates legally enforceable rights and obligations. However, this assessment may change if the exchange regulations are amended.

In order to consider as a "spot exchange rate" the exchange rate arising from the referred financial dollars, in addition to the legal enforceability, it is necessary to consider whether the foreign currency is immediately received by the purchaser, since the regulations may require the entity to hold the securities acquired for a certain period of time, known as "parking", before selling them and receiving the USD. As in the case of "administrative delay", it is the entity's management who needs to exercise its professional judgment to conclude about this matter, considering the circumstances in which the transaction takes place.

Is the existence of the parallel market (blue dollar) considered?

No. The amended IAS 21 clearly states that for the purpose of assessing whether a currency is exchangeable into another currency, transactions that do not create enforceable rights and obligations are not considered, which is precisely the case of transactions in the parallel market or blue dollar.

Which is the level used for assessment purposes?

The amended standard requires that the assessment of whether a currency is exchangeable into another currency (for example, whether ARS is exchangeable into USD) be made at the entity level considering its particular situation, within a particular timeframe.

No country-level consensus is required.

Since no country-level consensus is required, the amendment leaves the door open to entities to conclude in a different manner, since what matters is the own's entity reality rather than its specific context. This situation may pose difficulties upon comparing entities.

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Additionally, the amendment clarifies that the entity may determine that a currency is not exchangeable into another currency, even though that other currency might be exchangeable in the other direction. For instance, the ARS is not exchangeable into USD, but the USD are exchangeable into ARS.

Is the purpose of obtaining the other currency taken into account?

Different exchange rates might be available for different uses of a currency. For example, an exchange rate applicable to imports and another applicable to financial transactions or dividend remittances. Accordingly, the assessment of whether a currency is exchangeable into another currency should consider the purpose for which the entity needs to obtain the foreign currency.

This is not a new requirement: it is included in paragraph 26 of IAS 21 before the amendment, and it is applicable when several exchange rates are available for different purposes.

The assessment is based on the three purposes under IAS 21:

	Purpose of obtaining foreign currency
1. Transactions in foreign currency	To realize or settle assets or liabilities arising from transactions in foreign currency. In other words, for foreign currency transactions, the entity should assess the exchangeability of a currency separately for each individual transaction: sale of foreign currency to settle a foreign currency asset, purchase of foreign currency to settle a foreign currency liability.
2. Translation into the reporting entity's functional currency applicable to its foreign operations	To realize or settle its net investment in the foreign operation. When translating the financial information of a foreign operation into the entity's functional currency, the entity needs to assess whether it has an exchange rate available that allows it to receive the proceeds of the foreign operation.
3. Translation from the entity's functional currency into the entity's presentation currency of: • Its financial statements • Reporting package for consolidation by the parent company	To realize the entity's net assets to use a presentation currency other than the entity's functional currency. When translating information from the entity's functional currency into the presentation currency, the entity needs to assess whether it can obtain an exchange rate that allows it to realize the entity's net assets to use a presentation currency other than the entity's functional currency.

How can an entity's net investment in a foreign operation be realized? How can an entity's net assets be realized?

The amended IAS 21 clarifies that:

"An entity's net assets or net investment in a foreign operation might be realized by, for example:

(a) the distribution of a financial return to the entity's owners;

(b) the receipt of a financial return from the entity's foreign operation; or

(c) the recovery of the investment by the entity's owners, such as through disposal of the investment."

In other words, for the purpose of translating financial information, the entity needs to assess whether it has access to foreign currency for the remittance of interest or dividends or the repayment of principal to the entity's owners.

What if only limited amounts of foreign currency can be obtained?

The amendment considers that a currency is not exchangeable into another currency when no more than an insignificant amount of the foreign currency can be obtained.

The significance is determined considering the amount of the foreign currency that can be obtained for each of the specified purposes (settle assets or liabilities in foreign currency, realize net assets or investments in the foreign operation) by comparing that amount with the total amount of the currency required for that purpose.

If, for the payment of imports becoming due in the following month the entity needs to obtain USD 500,000, but it is only authorized to obtain USD 100,000 in the MULC, i.e. only 20% of the foreign currency required to meet the commitment, it is concluded that the ARS is not exchangeable.

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Example 1

The entity analyzes its transactions in foreign currency, which are basically imports from its parent company abroad.

Although the entity is able to access the MULC, the delay in obtaining the foreign currency to settle the liabilities exceeds 90 days. On the other hand, the entity may obtain financial dollars that do not require holding the securities for a given period prior to receiving the foreign currency.

The entity concludes that the ARS is exchangeable into USD through an exchange mechanism through securities. Consequently, it uses the exchange rate implicit in this transaction to measure transactions in foreign currency and its trade payables.

Example 2

The entity has established a branch in Uruguay, whose functional currency is the Uruguayan peso. In Uruguay, there are no restrictions on the remittance of dividends or eventually the repatriation of capital to Argentina.

The entity has access to the MULC for the sale of the Uruguayan pesos and the delay in obtaining the ARS is 2 days.

The entity concludes that the Uruguayan peso is exchangeable into ARS and, consequently, it uses the MULC exchange rates for the purpose of translating into ARS the branch's financial information prepared in Uruguayan pesos.

Example 3

The entity's functional currency is the USD, and it needs to present its financial statements in ARS.

Although the entity can obtain foreign currency within 5 days through the MULC for commercial transactions, which is considered a normal administrative delay, requests for payment of dividends are resolved by the applicable authorities within an uncertain period of time. On the other hand, the entity may obtain financial dollars, but obtaining foreign currency through the purchase and sale of securities requires the entity to hold the securities for a period of 30 days before selling them to obtain the foreign currency.

In this case, the entity concludes that the ARS is not exchangeable into USD due to the delay in receiving the foreign currency through the exchange mechanism and applies Step 2.

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Step 2

Estimating the spot exchange rate

When a currency is not exchangeable into another currency at measurement date, the amendment requires that the entity to estimate the spot exchange rate at such date.

The estimated spot exchange rate shall be:

- a rate at which an orderly exchange transaction would have taken place between market participants; and
- a rate that reflects the prevailing economic conditions.

What methodology is used to estimate the exchange rate?

The amendment does not establish any methodology for estimating the exchange rate, nor does it include hierarchies or preferences in case there are several methodologies.

Is it possible to use an observable exchange rate (without adjustments) as a spot exchange rate?

In estimating the spot exchange rate, an entity may use an observable exchange rate without adjustments, if that observable exchange rate reflects the rate at which an orderly exchange transaction would have taken place between market participants under the prevailing economic conditions.

Examples of observable exchange rates:

- spot exchange rate for a purpose other than that for which an entity assesses exchangeability
- the first exchange rate after exchangeability of the currency is restored.

Is it possible to use an observable exchange rate for another purpose as a spot exchange rate?

Let's consider the following cases:

- if the entity concludes that it has access to the MULC for import payments, but not for making payments abroad, is it possible to use the official exchange rate to measure the financial debt? or
- if the entity concludes that it has access to the MULC for import payments, but not for remitting dividends or repaying principal to the owners abroad, is it possible to use the official exchange rate to translate financial Information? Or else,
- if the entity concludes that it has access to the MULC for export receipts, but not for making payments abroad, is it possible to use the official exchange rate to measure its payables in foreign currency?

The amendment to IAS 21 allows an entity to use an observable exchange rate for another purpose as the estimated spot exchange rate, provided that such observable exchange rate reflects the rate at which an orderly exchange transaction would have taken place between market participants under the prevailing economic conditions.

Accordingly, the entity considers these factors, among others:

- whether several or just one observable exchange rates exist, since the existence of more than one observable exchange rates or only one observable exchange rate might indicate that exchange rates are set to encourage, or deter, entities from obtaining the other currency for a particular purpose. For example, there may be one observable exchange rate for imports of certain goods and another observable exchange rate for debt service payments and capital repatriation. By including incentives or penalties, the exchange rates might not reflect the prevailing economic conditions;
- the purpose for which the currency is exchangeable, since if an entity is able to obtain the other currency only for limited purposes (such as to import emergency supplies), the observable exchange rate might not reflect the prevailing economic conditions;
- the nature of the exchange rate, since it is more likely that a free-floating observable exchange rate reflects the prevailing economic conditions than an exchange rate set through regular interventions by the relevant authorities; and
- the frequency with which exchange rates are updated, since an observable exchange rate unchanged over time is less likely to reflect the prevailing economic conditions than an observable exchange rate that is updated more frequently.

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Example 4

Continuing with Example 3, whereby the entity's functional currency is the USD, it needs to present its financial statements in ARS, and it concluded that the ARS is not exchangeable into USD.

The entity assesses whether it may use the exchange rate arising from the MULC for the purpose of translating its financial statements prepared in USD into ARS, since it has access to the MULC to settle the foreign currency it obtains from its exports.

For the purposes of this assessment, the requirements of amended IAS 21 are as follows:

- Does the MULC exchange rate reflect the rate at which an orderly exchange transaction would have taken place between market participants? An analysis approach may be comparing the MULC exchange rate with other exchange rates arising from other exchange mechanisms.
- Does the MULC exchange rate reflect the prevailing economic conditions? An additional analysis approach may consider, in addition to the comparison of exchange rates arising from the MULC and the different exchange mechanisms, the analysis of relevant macroeconomic variables and indicators.

When use the first exchange rate after exchangeability of the currency is restored?

The entity may use the first exchange rate available after exchangeability of the currency is restored, provided that such exchange rate reflects the rate at which an orderly exchange transaction would have taken place between market participants under the prevailing economic conditions.

Accordingly, for assessment purposes, the entity considers these factors, among others:

- the time between the measurement date and the date at which exchangeability is restored. The shorter this period, the more likely the first subsequent exchange rate will reflect the prevailing economic conditions at measurement date; and
- inflation rates, since when an economy is highly inflationary, prices often change quickly and, consequently, the first exchange rate after exchangeability is restored might not reflect the prevailing economic conditions at measurement date.

Potential alternatives for the estimation

For the purposes of estimating the spot exchange rate, the entity may consider the so-called "financial dollars" (MEP dollar, CCL dollar) or even the unofficial USD exchange rate.

For example, if the entity needs to pay a debt in USD in the domestic market, it may consider the MEP as the most appropriate exchange rate. On the other hand, if the transfer of foreign currency is required for the payment of debts or dividends, the entity may consider the CCL dollar as the most appropriate exchange rate.

In estimating the exchange rate, the entity may consider exchange rates reported by unofficial markets. The amendment to IAS 21 requires disclosure of the estimating basis, including the methodology used.

Disclosure requirements

a. the currency and a description of the restrictions that result in that currency not being exchangeable into the other currency;

b. a description of affected transactions;

c. the carrying amount of affected assets and liabilities;

d. the spot exchange rates used and whether those rates are:

> i. observable exchange rates without adjustments (the first exchange rate available after exchangeability of the currency is restored or the observable exchange rate for another purpose); or
>
> ii. spot exchange rates estimated using another estimation technique;

e. a description of any estimation technique the entity has used, and qualitative and quantitative information about the inputs used in that estimation technique; and

f. 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.

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When a foreign operation's functional currency is not exchangeable into the presentation currency, the entity shall also disclose:

a. 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;

b. summarized financial information about the foreign operation, and

c. the nature and terms and conditions of any contractual arrangements that could require the entity to provide financial support to the foreign operation, including events or circumstances that might expose the entity to a loss.

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