EFRAG
European Financial Reporting Advisory Group

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

5 February 2016

Dear Sir/Madam,

**Re: Draft IFRIC Interpretation DI/2015/2 *Foreign Currency Transactions and Advance Consideration***

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Draft IFRIC Interpretation DI/2015/2, *Foreign Currency Transactions and Advance Consideration,* issued by the IASB on 21 October 2015 (the 'Draft Interpretation').

This letter is intended to contribute to the to the IFRS Interpretations Committee's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

EFRAG welcomes the guidance proposed in the Draft Interpretation, as we believe it will clarify the accounting for foreign currency transactions in which consideration was received or paid in advance of the recognition of the related asset, expense or income. We also agree with the proposed consensus and believe it is consistent with the underlying principles in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Our detailed comments and responses to the questions in the Draft Interpretation are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Vincent van Caloen or me.

Yours faithfully,

Roger Marshall
**Acting President of the EFRAG Board**

# APPENDIX

**Question 1 - Scope**

The Draft Interpretation addresses how to determine the date of the transaction for the purpose of determining the spot exchange rate used to translate foreign currency transactions on initial recognition in accordance with paragraphs 21–22 of IAS 21. Foreign currency transactions that are within the scope of the draft Interpretation are described in paragraphs 4–6 of the Draft Interpretation.

Do you agree with the scope proposed in the Draft Interpretation? If not, what do you propose and why?

**EFRAG's response**

**EFRAG agrees with the scope proposed in the Draft Interpretation.**

1 EFRAG agrees that there is a lack of guidance in IAS 21 *The Effects of Changes in Foreign Exchange Rates* on how to account for foreign currency transactions in which consideration was received or paid in advance of the recognition of the related asset, expense or income.

2 EFRAG therefore welcomes the guidance proposed in the Draft Interpretation, as we believe it will help clarify the accounting for these type of circumstances.

*Scope*

3 Paragraph 4 of the Draft Interpretation states that the Draft Interpretation applies to a foreign currency transaction (or part of it) in circumstances in which:

(a) There is consideration that is denominated or priced in a foreign currency;

(b) the entity recognises a prepayment asset or a deferred income liability in respect of that consideration, in advance of the recognition of the related asset, expense or income (or part of it; and

(c) the prepayment asset or deferred income liability is non-monetary

4 Paragraph 16 of IAS 21 states that the essential feature of a non-monetary item is the absence of a right to receive (or an obligation to deliver) a fixed and determinable number of units of currency. The paragraph notes the example of amounts prepaid for goods or services. Paragraph 23 of IAS 21 requires that foreign currency monetary items shall be translated using the closing rate, whilst non-monetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction. EFRAG therefore agrees with the scope proposed in paragraph 4 of the Draft Interpretation.

5 EFRAG notes that IAS 21 requires that when a non-monetary item is measured at fair value and fair value is determined in a foreign currency, the foreign currency amount is translated using the spot exchange rate at that measurement date. EFRAG therefore considers that if, after the initial recognition of a non-monetary prepayment asset or a non-monetary deferred income liability, that amount is required to be remeasured to reflect a fair value in a foreign currency on the initial recognition of the related asset, expense or income, the Draft Interpretation should not be applied as the current guidance in IAS 21 is clear.

*<u>Option not to apply the Draft Interpretation to insurance contracts and income taxes</u>*

6 EFRAG notes that the Draft Interpretation applies only to non-monetary items. We understand that it is for this reason that the Draft Interpretation need not be applied to insurance contracts and income taxes.

7 EFRAG notes that paragraph 16 of IAS 21 provides a list of some examples of items that are considered monetary items. Insurance contracts and income taxes are not listed in this paragraph. EFRAG would welcome guidance to clarify whether these items should be considered as monetary or non-monetary items.

8 As referred to in paragraph BC11 of the Basis for Conclusions of the Draft Interpretation, as part of the IASB's project on Insurance Contracts the IASB proposed in the Exposure Draft ED/2013/7 *Insurance Contracts* that insurance contracts should be treated as monetary items for the purposes of IAS 21. EFRAG notes that, to its knowledge, the ongoing redeliberations at the IASB have not resulted in any change to this proposal. Therefore EFRAG agrees that the Draft Interpretation need not be applied to insurance contracts.

*9* EFRAG notes that paragraph 78 of IAS 12 *Income Taxes* seems to suggest that deferred tax assets or liabilities are monetary items as the paragraph provides guidance on the recognition of exchange differences on deferred foreign tax liabilities or assets. EFRAG understands that this is a common interpretation applied in practice. On this basis, EFRAG agrees that the Draft Interpretation need not be applied to income taxes.

**Question 2 - Consensus**

The consensus in the draft Interpretation provides guidance on how to determine the date of the transaction for the purpose of determining the spot exchange rate used to translate the asset, expense or income (or part of it) on initial recognition that relates to, and is recognised on the derecognition of, a non-monetary prepayment asset or a non-monetary deferred income liability (see paragraphs 8–11). The basis for the consensus is explained in paragraphs BC22–BC33. This includes the Interpretations Committee's consideration of the interaction of the draft Interpretation and the presentation in profit or loss of exchange differences arising on monetary items in accordance with paragraphs 28–29 of IAS 21 (see paragraphs BC32–BC33).

Do you agree with the consensus proposed in the draft Interpretation? If not, why and what alternative do you propose?

**EFRAG's response**

**EFRAG agrees with the consensus and believes that the guidance is appropriate and aligned with the requirements in IAS 21. EFRAG agrees with the view expressed in the Basis for Conclusion of the Draft Interpretation that the presentation of exchange differences in profit or loss should not be addressed in this Draft Interpretation.**

10 EFRAG believes that the consensus is appropriate and aligned with the requirements in IAS 21.

*Date of the transaction*

11 Paragraphs 21-22 of IAS 21 require that a foreign currency transaction should be recorded, on initial recognition in the functional currency, by applying the spot exchange rate at the date of the transaction. Paragraph 22 of IAS 21 defines the date of the transaction as 'the date on which the transaction first qualifies for

recognition' in accordance with IFRS. Therefore EFRAG agrees that the guidance proposed by the Draft Interpretation is consistent with the principles in IAS 21.

12 EFRAG considers that, when the advance consideration gives rise to a non-monetary prepayment asset or a non-monetary deferred income liability, the entity is no longer exposed to foreign exchange risk in respect to the transaction to the extent that it has received or paid any consideration. The entity should therefore not recognise any exchange differences after that date.

13 However EFRAG agrees that, if an entity remains exposed to foreign exchange risk due to having paid or received only a portion of the consideration in advance, this unsettled portion of the asset, income or expense at the date that asset, income or expense should be initially recognised using the spot exchange rate at the date that asset, income or expense is recognised.

14 EFRAG acknowledges that there may be other views which support the reflection of any exposure to currency risk arising from the date of entering into a contract in the entity's profit or loss until the date that the obligation to pay or right to receive the consideration has been fulfilled. However, in EFRAG's view, this would require a change to IAS 21 because, as mentioned above, EFRAG believes that the proposed consensus in the Draft Interpretation is appropriate and aligned with the requirements in IAS 21.

20 Finally, EFRAG notes that paragraph 27 of the Basis for Conclusions of the Draft Interpretation states that the earliest date on which the first element of the transaction is recognised in the financial statements with a value determines the date of the transaction, in accordance with paragraph 22 of IAS 21. EFRAG observes that, recognising the related asset, expense or income at the exchange rate that applies at the contract inception date, would be inconsistent with the current accounting for executory contracts.

*Illustrative examples*

21 EFRAG recommends to illustrate the situation reflected in paragraph BC20 of the Basis for Conclusions of the Draft Interpretation in the illustrative examples in order to reflect the terms of a transaction give rise to a prepayment asset or a deferred income liability that is a foreign currency-denominated monetary item instead of a non-monetary item. This illustrative example could also address how the guidance should be applied to a revenue transaction with a significant financing component and, more specifically, clarify which exchange rate has to be used for the translation of the accreted amount.

*Other issues*

22 EFRAG recommends the removal of the footnote in the Basis for Conclusions of the Draft Interpretation which refers to the Exposure Draft ED/2015/3 *Conceptual Framework for Financial Reporting*, as the guidance has not yet been finalized.

**Question 3 - Transition**

On initial application, entities would apply the proposed Interpretation either:

(a) retrospectively in accordance with IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors; or

(b) prospectively to all foreign currency assets, expenses and income in the scope of the proposed Interpretation initially recognised on or after:

 (i) the beginning of the reporting period in which an entity first applies the proposed Interpretation; or

 (ii) the beginning of a prior reporting period presented as comparative information in the financial statements of the reporting period in which an entity first applies the proposed Interpretation.

Do you agree with the proposed transition requirements? If not, what do you propose and why?

**EFRAG's response**

**EFRAG agrees with the proposed transition guidance.**

23 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* allows prospective application when it is not practicable for the entity to restate its comparative information.

24 Whilst EFRAG acknowledges the potential negative effects on comparability of not restating the comparative periods, we understand that the Interpretations Committee has identified that the issue addressed by the Draft Interpretation primarily relates to the construction industry. In EFRAG's opinion, to require entities to restate transactions with multiple receipts or payments which are recognised over a considerable time would create a considerable burden on preparers that would outweigh the benefits for users.

25 Therefore EFRAG agrees that the option should be provided to preparers to implement the Draft Interpretation prospectively.