

## STAFF PAPER

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## IASB Meeting

<b>Project</b>	<b>Lack of Exchangeability (IAS 21)</b>		
<b>Paper topic</b>	Exchangeability and lack of exchangeability		
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### Introduction and purpose

1. As explained in Agenda Paper 12B for this meeting, this paper presents our analysis and recommendations on how to define exchangeability and, consequently, a lack of exchangeability.

### Structure of the paper

2. This paper includes:
  - (a) a summary of our recommendations (paragraphs 4–5); and
  - (b) our analysis and recommendations (paragraphs 6–76).
3. This paper also includes one appendix: Appendix A—Illustrative Examples.

### Summary our recommendations

4. We recommend specifying that a currency is exchangeable if an entity would be able to exchange that currency for another currency at a specified date. Accordingly, a currency would lack exchangeability when an entity would be unable to exchange that currency for another currency at a specified date.

5. Furthermore, we recommend specifying that when an entity assesses exchangeability (or a lack of exchangeability), it would:
- (a) consider whether it could obtain the foreign currency within a timeframe that includes a normal administrative delay.
  - (b) consider its ability to obtain foreign currency, and not its intention (or decision) to do so.
  - (c) consider only markets or exchange mechanisms that create enforceable rights and obligations.
  - (d) assume the purpose of obtaining foreign currency is:
    - (i) to settle individual foreign currency transactions, or assets or liabilities related to those transactions, when it reports foreign currency transactions in the functional currency; or
    - (ii) to realise the entity's net assets when it uses a presentation currency other than the functional currency (or to realise its net investment in a foreign operation when it translates the results and financial position of that foreign operation).
  - (e) in circumstances in which it is able to obtain only some amounts of foreign currency, conclude that exchangeability is lacking when, for a particular purpose, it is able to obtain no more than an insignificant amount of foreign currency. For example, for the purpose of translating a monetary liability of FC1,000 into its functional currency, assume an entity is able to obtain an amount of foreign currency of only FC400 to settle that liability. In this situation, the entity is able to obtain more than an insignificant amount of foreign currency to settle the liability and would therefore conclude that the currency is exchangeable for this particular purpose. Additionally, we recommend that when an entity (a) reports foreign currency transactions in its functional currency, and (b) can obtain less than the amount of foreign currency it needs to settle all balances and transactions in that currency, the entity assess exchangeability on an aggregated basis for all the related foreign currency balances and transactions.

## Staff analysis and recommendations

### *Defining exchangeability*

6. IAS 21 does not specify when a currency is exchangeable. For the purpose of applying IAS 21, we recommend specifying that a currency is exchangeable if an entity would be able to exchange that currency for another currency at a specified date. Accordingly, a currency would lack exchangeability when an entity would be unable to exchange that currency for another currency at a specified date.
7. Many factors influence a currency's exchangeability and assessing whether a currency is exchangeable could be complicated. To operationalise the definition proposed above, we recommend specifying when an entity would be able to obtain foreign currency and when not. To identify those circumstances, we considered the following questions:
  - (a) what is the timeframe within which an entity is able to settle a foreign currency transaction? (Question 1);
  - (b) what if an entity is able to exchange a currency, but does not intend to? (Question 2);
  - (c) which means of accessing foreign currency does an entity consider? (Question 3);
  - (d) what is the purpose for which an entity obtains foreign currency? (Question 4); and
  - (e) what if an entity is able to exchange only some amounts of foreign currency? (Question 5).

### ***Question 1: what is the timeframe within which an entity is able to settle a foreign currency transaction?***

#### *Analysis*

8. In assessing whether a currency is exchangeable, it is important to consider the timeframe within which an entity is able to settle a foreign currency transaction—ie the time between entering into an exchange transaction and obtaining delivery of the foreign currency.

9. IAS 21 defines a spot rate as ‘the exchange rate for immediate delivery’. Accordingly, when an entity assesses exchangeability and uses a spot rate, the entity would consider whether it could obtain immediate delivery of the foreign currency.
10. The completion of an exchange transaction may not always occur instantaneously. This is because of:
  - (a) legal or regulatory requirements applying to some exchange transactions. Such requirements may mean that particular exchange transactions are subject to controls or verification procedures, such as the inspection of documents. These controls and procedures could result in delays in settling foreign currency transactions.
  - (b) practical considerations, such as the existence of statutory holidays.
11. In our view, assessing whether a currency is exchangeable necessarily considers that delays of an administrative nature might be unavoidable in completing an exchange transaction. Such delays would depend on the facts and circumstances. We think the notion of ‘immediate delivery’ includes this type of delay. Ignoring normal administrative delays would lead to entities concluding that exchangeability is lacking when there is no genuine lack of exchangeability. It would be useful to specify this in any proposed amendment.
12. We also recommend providing no application guidance on what would constitute a ‘normal administrative delay’. This is because the assessment would depend on facts and circumstances (for example, the jurisdiction in which an exchange transaction occurs, the type of exchange mechanism, etc.). We think entities should be able to apply the notion of a ‘normal administrative delay’ without additional requirements.
13. Paragraphs A3–A4 of Appendix A illustrate the analysis in this respect.

*Recommendation*

14. We recommend:
  - (a) specifying that in assessing exchangeability (or a lack thereof), an entity considers whether it could obtain foreign currency within a timeframe that includes a normal administrative delay. Accordingly, when an entity assesses whether a currency is exchangeable and uses a spot rate, the entity

considers whether it would be able to obtain immediate delivery of foreign currency, considering a normal administrative delay.

- (b) not providing application guidance on what would constitute a normal administrative delay.

**Question 2: what if an entity is able to exchange a currency, but does not intend to?**

*Analysis*

- 15. As outlined in paragraph 6 of this paper, assessing whether a currency is exchangeable depends on an entity's ability to obtain foreign currency. This is an entity-specific assessment of the facts and circumstances.
- 16. It is possible for entities in the same jurisdiction to reach different conclusions about the exchangeability of a currency if the circumstances of those entities differ. For example, when jurisdictional authorities administer a currency's exchangeability, some entities may be able to obtain foreign currency for particular transactions (importing food, medicines, etc.), while other entities that do not enter into such transactions would not.
- 17. An entity's intentions or decisions regarding exchanging a currency would not be relevant to an assessment of exchangeability. A currency would be exchangeable if an entity is able to obtain foreign currency even if it decides or intends not to do so. Exchangeability is lacking when laws, regulations or controls prevent an entity from being able to obtain foreign currency.
- 18. Paragraphs A5–A8 of Appendix A illustrate the analysis in this respect.

*Staff recommendation*

- 19. We recommend that in assessing exchangeability (or a lack thereof), an entity considers its ability to obtain foreign currency and not its intention (or decision) to do so.

**Question 3: which means of accessing foreign currency does an entity consider?**

*Analysis*

20. When assessing whether a currency is exchangeable, we recommend that an entity consider only exchange mechanisms or markets that create enforceable rights and obligations. Enforceability is a matter of law. The assessment of whether an exchange mechanism or market creates enforceable rights and obligations depends on the particular facts and circumstances.
21. When the exchangeability of a currency is administered by jurisdictional authorities, there are often ‘parallel markets’ through which an entity may be able to obtain foreign currency. An entity considers those markets in assessing whether a currency is exchangeable only if those markets create enforceable rights and obligations.
22. At the November 2019 Board meeting, one Board member asked whether it would be better to refer to ‘legal’ or ‘legally permissible markets’ rather than to markets creating enforceable rights and obligations. The Interpretations Committee (Committee) considered but decided not to recommend referring to ‘legal’ or ‘legally permissible markets’. Feedback received at the [March 2019 Emerging Group Meeting](#) indicated that assessing whether a market creates enforceable rights and obligations would be (a) more operational and (b) less prone to ‘moral’ judgement about a market’s ‘legality’.
23. We agree with the Committee’s view and continue to think that the reference to markets creating enforceable rights and obligations is appropriate.
24. Paragraphs A9–A12 of Appendix A illustrate the analysis in this respect.

*Staff recommendation*

25. We recommend that in assessing exchangeability (or a lack thereof), an entity considers only markets or exchange mechanisms that create enforceable rights and obligations.

**Question 4: what is the purpose for which an entity obtains foreign currency?**

*Analysis*

*Why does this matter?*

26. In many jurisdictions (particularly where exchange rates are determined through market forces), there is only one exchange rate—an entity’s use of the foreign currency would not change the exchange rate for immediate delivery or affect the entity’s ability to obtain foreign currency.
27. However, in other jurisdictions (particularly where jurisdictional authorities administer foreign currency transactions), there may be different rates for differing uses of foreign currency. For example, a jurisdiction facing strong pressure on its balance of payments might wish to deter capital outflows (such as dividend remittances abroad) but encourage imports of goods. In such circumstances, the jurisdictional authorities might:
  - (a) set a preferential rate for imports of goods and a ‘penalty rate’ for dividend remittances (or similar capital transactions), thus resulting in different exchange rates for the same currency, and/or
  - (b) through restrictions, allocate foreign currency only to import goods but not to capital transactions abroad.
28. Accordingly, the assessment of an entity’s ability to obtain foreign currency could depend on the purpose for which the foreign currency is obtained. For example, in the situation described above in paragraph 27(b) an entity might be able to obtain foreign currency for importing goods but unable to obtain it to remit dividends abroad.

*What is the purpose for which foreign currency is obtained?*

29. IAS 21 has different requirements for (a) the reporting of foreign currency transactions in the functional currency, and (b) using a presentation currency other than the functional currency. We considered these separately in our assessment.

*Reporting foreign currency transactions in the functional currency*

30. Paragraphs 20–37 of IAS 21 specify requirements for the reporting of foreign currency transactions in the functional currency. Those requirements apply to individual foreign currency transactions, and to monetary and non-monetary items

relating to those transactions. Accordingly, when reporting foreign currency transactions in the functional currency, we recommend that an entity assess a currency's exchangeability separately for each individual transaction, asset or liability—ie in assessing exchangeability, the entity would assume the purpose of obtaining foreign currency is to settle the individual transaction, asset or liability. Therefore, an entity would assess whether it is able to obtain foreign currency to settle that transaction, or the asset or liability related to that transaction.

31. Paragraph 26 of IAS 21 already requires an entity to consider the exchange rate that it uses for each transaction or balance in situations in which several exchange rates are available<sup>1</sup>. Our recommendation would therefore align with the requirements in paragraph 26 of IAS 21. Applying our recommendation, an entity might conclude that a currency is exchangeable for some transactions or balances, but not exchangeable for others.
32. Paragraphs A13–A15 of Appendix A illustrate the analysis in this respect.

#### Using a presentation currency other than the functional currency

33. Paragraphs 38–49 of IAS 21 specify requirements for the use of a presentation currency other than the functional currency. Those requirements apply when an entity:
  - (a) presents its financial statements in a currency that is not its functional currency; or
  - (b) translates the results and financial position of a foreign operation in preparing its consolidated financial statements.

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<sup>1</sup> Paragraph 26 of IAS 21 states (emphasis added): 'When several exchange rates are available, the rate used is that at which the future cash flows represented by *the transaction or balance* could have been settled if those cash flows had occurred at the measurement date...'

34. These requirements apply to the entire group of assets or liabilities (ie net assets) and not to the individual assets and liabilities of the reporting entity or the foreign operation. This is because paragraphs 38–49 of IAS 21:
- (a) refer to the ‘results and financial position’ of the entity or foreign operation; and
  - (b) require an entity to translate all assets and liabilities at the closing rate (applying the requirements in paragraphs 39(a) and 42(a)) without distinguishing between monetary and non-monetary items or changing the underlying measurement of those assets and liabilities.
35. Specifically, when an entity translates the results and financial position of a foreign operation, the entity considers its ‘net investment in the foreign operation’. Paragraph 8 of IAS 21 defines the net investment in a foreign operation as ‘the amount of the reporting entity’s interest in the net assets of that operation’.
36. Accordingly, when using a presentation currency other than the functional currency (and translating the results and financial position of a foreign operation), an entity should assess a currency’s exchangeability by considering its net assets (or net investment in the foreign operation). This means that, in assessing exchangeability, an entity would consider it from the perspective of a transaction that would result in realising its net assets (or net investment in the foreign operation).
37. The net assets or net investment might be realised by:
- (a) distributing a financial return to the entity’s owners, or the reporting entity earning a financial return on the net investment (through dividends or similar payments); or
  - (b) recovery by the entity’s owners of their investment, such as through disposal of their net investment.<sup>2</sup>
38. In the light of the analysis set out above, an entity would use the spot rate that applies to transactions resulting in the realisation of its net assets (or net investment in a

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<sup>2</sup> We expect that in most situations the exchange rate for dividend remittances would not be different from the exchange rate that would apply to a recovery of investments. If those rates were different, an entity would apply judgement in determining the applicable rate.

foreign operation) when the entity uses a presentation currency other than the functional currency.

39. We understand that most entities use the ‘dividend remittance rate’ (or more generally the rate that applies to investment-related payments) to translate the results and financial position of foreign operations into the presentation currency. Therefore, our recommendation would align with this practice.
40. Paragraphs A13–A14 and A16–A17 of Appendix A illustrate the analysis in this respect.

#### *Matters specifically considered*

41. We summarise below the matters that we considered when developing our recommendation on Question 4.

#### *Using several exchange rates for a currency*

42. The analysis set out above could result in entities possibly using several exchange rates when reporting foreign currency transactions. This could create implementation challenges because reporting systems might not be set up to manage several exchange rates for one currency.
43. Nonetheless, as explained in paragraph 31 of this paper, paragraph 26 of IAS 21 already requires an entity to use different exchange rates for one currency when (a) several exchange rates exist, and (b) the entity reports foreign currency transactions in the functional currency. Accordingly, our proposed approach would not create new implementation challenges.

#### *Scope of the proposed amendments*

44. At the November 2019 Board meeting, one Board member said entities might sometimes undergo long delays when remitting dividends from some jurisdictions. If any amendment were to specify, for example, that the purpose of obtaining currency is to realise an entity's net assets, then there is a risk that this might result in identifying many currencies that are not exchangeable—this could be contrary to the Board’s intention.
45. Consistent with our recommendation in Question 1 (see paragraph 14 of this paper), the existence of delays when remitting dividends would not necessarily result in a lack

of exchangeability if that delay is reflective of a ‘normal administrative delay’. We also note the interaction between this factor and our recommendations regarding the exchange rate discussed in Agenda Paper 12D. Based on our recommendations in that paper, assessing that a currency lacks exchangeability would not automatically result in the use of an estimation technique—in several situations, an entity might still use an observable rate.

*Purpose of obtaining foreign currency when an entity uses a presentation currency other than the functional currency*

46. When discussing our recommendations with the Committee, some Committee members observed that:
  - (a) requiring entities to consider a transaction that would result in realising its net assets (or net investment in the foreign operation) would not necessarily reflect an entity’s decisions. In the case of a foreign operation, an entity might often decide to realise its net investment through dividend-remittances (or financial returns) over time, rather than through a recovery of the net investment.
  - (b) an entity might be unable to recover its entire net investment in a foreign operation in a single transaction. Accordingly, any amendment might need to consider an entity’s ability to recover the net investment over time (such as through dividend-remittances over several years).
  
47. Paragraphs 33–40 of this paper explain why we recommend that an entity consider a transaction that would result in realising its net assets or net investment in a foreign operation when assessing the purpose for which it obtains foreign currency. That approach is consistent with the requirements in IAS 21.
  
48. We agree that an entity might often be unable to realise its net assets or net investment in a foreign operation in a single transaction. Such circumstances arise in particular when jurisdictional authorities administer a currency’s exchangeability—when jurisdictional authorities have limited currency reserves, they often restrict the supply of foreign currency so that it is made available only for particular transactions (such as the importation of essential food and medicines). In those circumstances, the jurisdictional authorities are unlikely to give priority to the settlement of capital transactions.

49. Nonetheless, we think that concerns on this matter would be mitigated by the recommendation in Question 5 (see paragraphs 51–74 of this paper)—ie that an entity would consider a currency to be exchangeable if it can obtain more than an insignificant amount of foreign currency. Applying that recommendation, a currency would therefore be exchangeable if an entity could realise more than an insignificant amount of its net assets (or net investment in the foreign operation) in a single transaction.

*Staff recommendation*

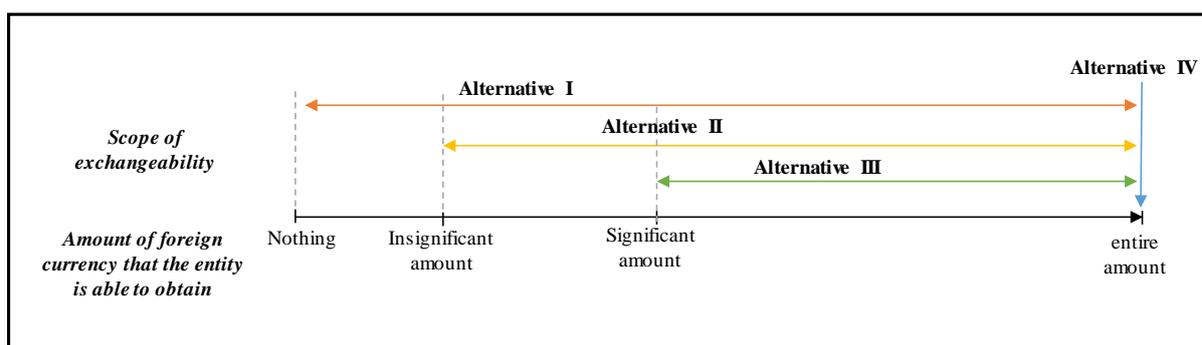
50. We recommend that in assessing exchangeability (or a lack thereof), an entity would assume the purpose of obtaining foreign currency is:
- (a) to settle individual foreign currency transactions, or assets or liabilities related to those transactions, when it reports foreign currency transactions in the functional currency; or
  - (b) to realise the entity’s net assets when it uses a presentation currency other than the functional currency (or to realise its net investment in a foreign operation when it translates the results and financial position of that foreign operation).

**Question 5: what if an entity is able to exchange only some amounts of foreign currency?**

*Analysis*

51. An entity might be able to obtain only some amounts of foreign currency—for example, an entity with a foreign currency denominated liability of FC1,000 might be able to obtain only FC400 to settle that liability through an exchange mechanism. Is the currency exchangeable (because the entity is able to obtain some amounts of foreign currency) or not exchangeable (because the entity is unable to obtain all foreign currency required to settle that liability)?

52. We considered four possible alternatives in this respect. A currency would be exchangeable if, for a particular purpose<sup>3</sup>, an entity is able to obtain:
- (a) even an insignificant<sup>4</sup> amount of foreign currency (Alternative I);
  - (b) more than an insignificant amount of foreign currency (Alternative II);
  - (c) more than a significant amount of foreign currency (Alternative III); or
  - (d) the entire amount of foreign currency (Alternative IV).
53. The diagram below illustrates the proposed alternatives for exchangeability:

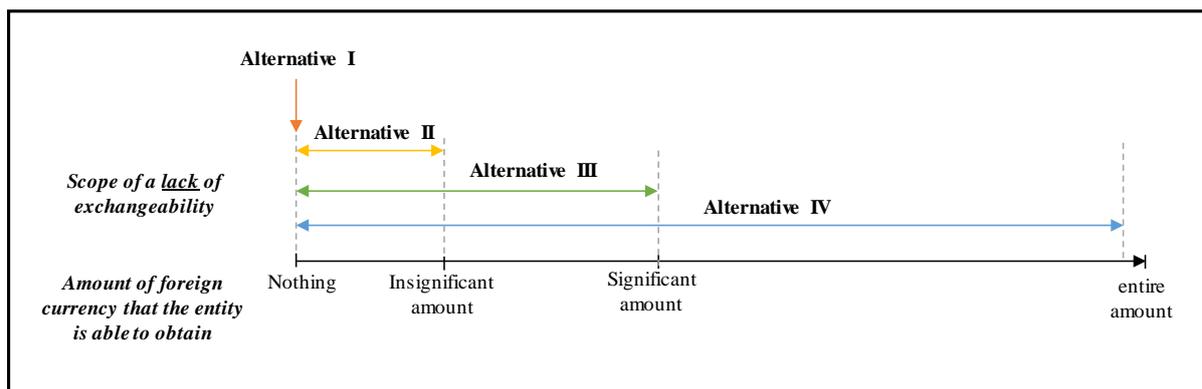


54. Accordingly, a currency would *not* be exchangeable if, for a particular purpose, an entity is able to obtain:
- (a) no amount of foreign currency (Alternative I);
  - (b) no more than an insignificant amount of foreign currency (Alternative II);
  - (c) no more than a significant amount of foreign currency (Alternative III); or
  - (d) less than the entire amount of foreign currency (Alternative IV).

<sup>3</sup> Paragraphs 26–50 of this paper discuss the purpose of obtaining foreign currency.

<sup>4</sup> Paragraphs 59 and 61 explain how, in our view, an entity assesses the relative notions of ‘significant’ or ‘insignificant’.

55. The diagram below illustrates the proposed alternatives for a lack of exchangeability:



56. This diagram shows that Alternative I would result in the narrowest set of circumstances in which exchangeability is lacking. This is because, applying Alternative I, exchangeability is lacking only if an entity could not obtain any amount of foreign currency (even if it might be able to obtain only an insignificant amount). In contrast, Alternative IV would result in the broadest set of circumstances in which exchangeability is lacking. This is because, applying Alternative IV, exchangeability is lacking if an entity could not obtain the entire amount of foreign currency (even if it might be able to obtain almost all of the amount).

57. The following paragraphs illustrate how an entity would apply these alternatives in different situations.

*Reporting foreign currency transactions in the functional currency*

58. Consistent with our analysis in paragraphs 30–32 of this paper, the purpose of obtaining foreign currency in this situation would be to settle the individual foreign currency transactions, or assets or liabilities related to those foreign currency transactions.

59. Applying the alternatives described above in paragraph 52 to this purpose, a currency would be exchangeable if the entity is able to obtain:

- (a) even an insignificant amount of foreign currency required to settle the asset or liability related to a foreign currency transaction (Alternative I);
- (b) more than an insignificant amount of foreign currency required to settle that asset or liability (Alternative II);

- (c) more than a significant amount of foreign currency required to settle that asset or liability (Alternative III); or
- (d) the entire amount of foreign currency required to settle that asset or liability (Alternative IV).

*Using a presentation currency other than the functional currency*

60. Consistent with the analysis in paragraphs 33–40 of this paper, the purpose of obtaining foreign currency in this situation would be the realisation of an entity’s net assets (or net investment in a foreign operation if translating the results and financial position of that foreign operation).
61. For example, assume that a reporting entity has a foreign operation. Applying the alternatives described above in paragraph 52, a currency would be exchangeable if the foreign operation is able to obtain foreign currency that would enable the reporting entity to realise:
- (a) even an insignificant amount of its net investment in the foreign operation (Alternative I);
  - (b) more than an insignificant amount of that net investment (Alternative II);
  - (c) more than a significant amount of that net investment (Alternative III); or
  - (d) all of that net investment (Alternative IV).

*Comparison of the alternatives*

62. Alternative I (ie exchangeability is lacking only when an entity cannot obtain any amount of foreign currency) would be very restrictive and would apply only in most extreme situations. At the other end of the spectrum, Alternative IV (ie exchangeability is lacking when an entity cannot obtain the entire amount of foreign currency) would lead to many situations being captured within the scope of any amendment, which could lead to unintended consequences. Accordingly, we recommend the Board not consider these options further.
63. In considering Alternatives II and III, we recommend Alternative II (ie exchangeability is lacking when an entity is able to obtain no more than an insignificant amount of foreign currency). This is because this alternative would have a narrower scope than Alternative III, but without being overly restrictive. This

alternative is consistent with our view that any amendment should apply only in a relatively narrow set of circumstances. We also note the interaction between this factor and the possible requirements for the exchange rate discussed in Agenda Paper 12D—our recommendation in that paper is to require the use of an estimated rate when exchangeability is lacking. We see benefits in narrowing the circumstances in which an entity would apply an estimated rate.

64. We acknowledge that there is limited conceptual basis for selecting either Alternative II or Alternative III. Neither IAS 21, nor the 2018 *Conceptual Framework for Financial Reporting*<sup>5</sup>, provide principles or requirements that could help determine which alternative is more appropriate from a conceptual perspective. Nonetheless, for the reasons outlined in paragraph 63 of this paper, we recommend Alternative II—that alternative strikes a balance between the scope of any amendment and providing a faithful representation of the information reported.
65. We note that the approach we recommend is similar to the approach in IFRS 13 *Measurement of Fair Value* with respect to the measurement of fair value when the volume or level of activity for an asset or a liability has significantly decreased (paragraphs B37–B42 of IFRS 13). Applying these paragraphs, when an entity determines that the volume or level of activity has significantly decreased, it assesses whether a transaction or quoted price represents fair value (as defined in paragraph 9 of IFRS 13). If the transaction or quoted price does not represent fair value, the entity adjusts that observable price (transaction or quoted price).
66. We think the situation described in Question 5 can be analogised to a market in which *few* transactions occur for an asset or a liability. In such a market, the reduced level of activity may lead an entity to depart from the observable prices (transaction or quoted price) when estimating the asset or liability’s fair value. Similarly, when considering this question, we recommend an entity depart from the observable spot rate and instead, estimate that rate (see Agenda Paper 12D) when the entity is able to obtain no more than an insignificant amount of foreign currency—ie when the activity of the

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<sup>5</sup> Paragraph BC0.17 of the 2018 *Conceptual Framework for Financial Reporting* states: ‘in developing the 2018 Conceptual Framework, the Board did not address the equity method of accounting, the translation of amounts denominated in foreign currency or the restatement of the measuring unit in hyperinflation. The Board concluded that these issues would best be dealt with if it were to carry out projects to consider revising Standards on these topics’.

market in which it exchanges foreign currency is so low that it can obtain only an insignificant amount of foreign currency.

67. At the November 2019 Board meeting, some Board members supported Alternative IV—ie exchangeability is lacking when an entity is able to obtain less than the entire amount of foreign currency. Consistent with their view on this matter, they suggested modifying our recommendations on how an entity determines the spot rate in those circumstances which would, in their view, result in similar outcomes to our proposed approach. Because of the interrelationship between this suggestion and the approach we recommend in Agenda Paper 12D for this meeting, Appendix B to Agenda Paper 12D discusses and analyses this suggestion in more detail.

*Level at which to make this assessment*

*The matter*

68. In this section, we consider a matter that may arise in assessing a currency's exchangeability when an entity reports foreign currency transactions in its functional currency. In some circumstances, an entity might be able to obtain only a finite amount of foreign currency, but this amount might be lower than the total amount of foreign currency balances or transactions for which the entity is assessing exchangeability.
69. For example, assume an entity whose functional currency is the LC has four trade payables denominated in USD. The balance of each payable is USD25 and the sum of the balances of those payables is USD100. The entity would be able to obtain foreign currency for a total amount of USD25, ie an amount lower than USD100. In this case, there is a question about the level at which the entity assesses whether it is able to obtain more than an insignificant amount of foreign currency:
- (a) if the entity considers each payable separately, it would need to allocate the available USD25 to the four payables. To do so, the entity could, for example, allocate that amount:
    - (i) on a residual basis—ie by allocating USD25 to one payable and a nil amount to the three other payables. In that case, the entity would conclude there is exchangeability for one payable (because it is able to obtain more than insignificant amount to settle that payable) and no exchangeability for the three other

payables (because it is able to obtain no more than an insignificant amount to settle those payables) (residual method);  
or

- (ii) on the basis of the relative balances of the items—ie by allocating USD6.25 (USD 25÷4) to each payable. In that case, the entity would assess, for each payable, whether the USD6.25 it is able to obtain is more than insignificant in relation to the USD25 balance of the payable. Applying this approach, the entity would conclude that either all or none of the payables are exchangeable (proportional method).
- (b) if the entity were to consider the payables on an aggregated basis, it would assess whether the total amount of foreign currency it would be able to obtain (USD25) is more than insignificant in comparison to the aggregated amount of the payables' balances (USD100). In this case, the entity would also conclude that either all or none of the payables are exchangeable (aggregate method).

### *Staff analysis*

- 70. As explained in paragraph 30 of this paper, when reporting foreign currency transactions in the functional currency, an entity assesses a currency's exchangeability separately for each individual transaction, asset or liability. Accordingly, in the example discussed in paragraph 69, we think the entity should assess whether each payable is exchangeable. Accordingly, the entity would need to allocate the available amount of USD (ie USD25) to each payable (alternately, the entity could also allocate the USD75 'foreign currency shortage'<sup>6</sup> to each payable).
- 71. While there could be several ways of allocating the amount of available foreign currency, we think using the proportional method would provide information that is faithfully representative. This is because any 'foreign currency shortage' would be allocated proportionally to all items. In the example above, we see no reason to think that an entity obtains the USD25 amount to settle only *some* of the four payables<sup>7</sup>.

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<sup>6</sup> Calculated as total amount of payables of USD100 less available amount—ie USD25.

<sup>7</sup> Unless there is evidence that foreign currency would not be available to settle some payables because, for example, jurisdictional authorities prohibit obtaining foreign currency to settle those payables.

Other allocations methods (such as the residual method) would result in arbitrary allocations of the available foreign currency.<sup>8</sup>

72. We note that the outcome of the proportionate method (see paragraph 69(a)(ii)) is equivalent to the outcome of the aggregate method (see paragraph 69(b)). Accordingly, we recommend specifying that when an entity (a) reports foreign currency transactions in its functional currency, and (b) can obtain less than the amount of foreign currency it needs to settle all balances and transactions in that currency, the entity assesses exchangeability on an aggregated basis for all the related foreign currency balances and transactions.

*Staff recommendations*

73. We recommend that in assessing exchangeability (or a lack thereof) in situations in which an entity is able to obtain only some amounts of foreign currency, exchangeability is lacking when, for a particular purpose, an entity is able to obtain no more than an insignificant amount of foreign currency.
74. Additionally, we recommend that when an entity (a) reports foreign currency transactions in its functional currency, and (b) can obtain less than the amount of foreign currency it needs to settle all balances and transactions in that currency, the entity assess exchangeability on an aggregated basis for all the related foreign currency balances and transactions.

**Staff recommendations**

75. Based on our analysis, we recommend specifying that a currency is exchangeable if an entity would be able to exchange that currency for another currency at a specified date. Accordingly, exchangeability of a currency is lacking when an entity would be unable to exchange that currency for another currency at a specified date.

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<sup>8</sup> We note that our proposed approach in this paragraph is similar to the approach that the Board retained in IFRS 15 *Revenue from Contracts with Customers* with respect to the requirements for the allocation of the transaction price to performance obligations in a contract (see paragraphs 73–86 of IFRS 15).

76. Furthermore, we recommend specifying that when an entity assesses exchangeability (or a lack of exchangeability), it would:
- (a) consider whether it could obtain the foreign currency within a timeframe that includes a normal administrative delay.
  - (b) consider its ability to obtain foreign currency, and not its intention (or decision) to do so.
  - (c) consider only markets or exchange mechanisms that create enforceable rights and obligations.
  - (d) assume the purpose of obtaining foreign currency is:
    - (i) to settle individual foreign currency transactions, or assets or liabilities related to those transactions, when it reports foreign currency transactions in the functional currency; or
    - (ii) to realise the entity's net assets when it uses a presentation currency other than the functional currency (or to realise its net investment in a foreign operation when it translates the results and financial position of that foreign operation).
  - (e) in circumstances in which it is able to obtain only some amounts of foreign currency, conclude that exchangeability is lacking when, for a particular purpose, it is able to obtain no more than an insignificant amount of foreign currency. Additionally, we recommend that when an entity (a) reports foreign currency transactions in its functional currency, and (b) can obtain less than the amount of foreign currency it needs to settle all balances and transactions in that currency, the entity assess exchangeability on an aggregated basis for all the related foreign currency balances and transactions.

**Question for the Board**

Does the Board agree with our analysis and recommendations on how to define a currency's exchangeability or lack of exchangeability?

## Appendix A—Illustrative Examples

- A1. This appendix sets out examples that illustrate how an entity would assess exchangeability considering the factors discussed in paragraphs 8–50 of this paper.
- A2. The examples have been prepared on the basis that:
- (a) Entity X, a reporting entity, has a functional and presentation currency of GBP. Entity X prepares consolidated financial statements.
  - (b) Entity X has a subsidiary, Entity Y (which is a foreign operation). Entity Y’s functional currency is LC, the local currency of the jurisdiction in which Entity Y operates. The jurisdictional authorities administer the exchangeability of LC.

### ***Timeframe within which an entity is able to settle a foreign currency transaction***

- A3. This example assumes that the jurisdictional authorities deliver foreign currency (including GBP) to entities only after the completion of an administrative process. An entity wishing to obtain foreign currency is required to submit a form and explain how it intends to use the currency. In usual circumstances, an entity obtains foreign currency at the official exchange rate after 21 days—ie the time the jurisdictional authorities need to perform checks and deliver the foreign currency.
- A4. Considering our analysis in paragraphs 8–14, Entity Y would consider 21 days to be a normal administrative delay applying to an exchange transaction through the official exchange mechanism. Entity Y would consider LC to be exchangeable if it can obtain GBP within 21 days of submitting the form.

### ***Intention to exchange a currency***

- A5. This example assumes that the jurisdictional authorities specify one official exchange rate of GBP1: LC10. There is no restriction on access to GBP at this rate.
- A6. International institutions report that the official exchange rate has been set in a manner that does not faithfully reflect the economic conditions prevailing in the jurisdiction. Economists say a rate of GBP1: LC5 would faithfully reflect those economic conditions.

- A7. Entity X has approved a dividend distribution by Entity Y but does not allow Entity Y to proceed with paying dividends until the official exchange rate decreases. Accordingly, Entity Y does not intend to enter an exchange transaction through the official exchange mechanism (there are no other exchange mechanisms).
- A8. In such circumstances, Entity Y is able to obtain foreign currency for dividend remittances. However, Entity Y's management decides not to obtain any foreign currency at this time for economic reasons. Considering our analysis in paragraphs 15–19, Entity Y would observe that it is not prevented by law, regulation or specific controls from obtaining foreign currency for dividend remittances. Entity Y would therefore conclude that LC is exchangeable for that particular purpose.

***Means of accessing foreign currency***

- A9. This example assumes that the jurisdictional authorities are unable to meet local demand for foreign currency and temporarily stop allocating foreign currency through the exchange mechanism they administer.
- A10. The jurisdictional authorities previously had exclusive responsibility for allocating foreign currency within the jurisdiction. In the absence of an official exchange mechanism, individual resellers settle exchange transactions at an exchange rate not set by the jurisdictional authorities. Transactions with those resellers do not create enforceable rights and obligations. There are no other exchange mechanisms or markets which would create enforceable rights and obligations.
- A11. As explained in paragraphs 20–25, Entity Y would consider only exchange mechanisms or markets that create enforceable rights and obligations in assessing whether LC is exchangeable.
- A12. Because the transactions with individual resellers do not create enforceable rights and obligations, Entity Y would not consider this exchange market when it assesses whether LC is exchangeable. Because there are no other exchange mechanisms or markets, Entity Y would conclude that exchangeability of LC is lacking.

### ***Purpose of obtaining foreign currency***

- A13. This example assumes that LC is exchangeable for imports of goods and services (without any restriction on the amount of foreign currency that Entity Y could obtain), but restrictions prevent the entity from being able to obtain foreign currency to recover investments.
- A14. The official exchange rates applicable for imports of goods and services at the reporting date are as follows:
- (a) a preferred rate of GBP1: LC5 for imports of food and medicines; and
  - (b) a rate of GBP1: LC50 for imports of other goods and services.

#### *Entity Y reports foreign currency transactions in its functional currency*

- A15. Entity Y applies the requirements in paragraph 26 of IAS 21—ie it uses the exchange rate at which the future cash flows represented by each transaction could have been settled if those cash flows had occurred at the reporting date. For example, if Entity Y has a trade payable (arising from the purchase of goods that are not food or medicines) denominated in GBP, it reports the amount of this monetary item using the spot rate between LC and GBP that would apply if the settlement of the trade payable were to occur at the reporting date—ie a rate of GBP1: LC50. In this situation, LC is exchangeable for the trade payable because Entity Y is able to obtain foreign currency to settle that payable.

#### *Entity X translates the results and financial position of Entity Y*

- A16. Entity X would translate the results and financial position of Entity Y using the exchange rate that would apply in realising its net investment in Entity Y.
- A17. In this situation, exchangeability of LC is lacking. This is because, at the reporting date, Entity Y is able to obtain no more than an insignificant amount of foreign currency to enable Entity X to realise its net investment in Entity Y. In other words, LC is not exchangeable for the purpose of realising Entity X's net investment in Entity Y. The fact that Entity Y is able to obtain foreign currency for other purposes is not relevant to the assessment.