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Introduction and purpose

1. Agenda Paper 14 for this meeting explains the background to the research undertaken regarding the exchange rate an entity uses when the spot exchange rate (as defined in IAS 21 *The Effects of Changes in Exchange Rates*) is not observable. This paper presents our analysis and recommendations on how to define exchangeability and, consequently, a lack of exchangeability.

Structure

2. This paper includes:

   (a) summary of our recommendations (paragraphs 4–5);

   (b) background information (paragraphs 6–13); and

   (c) our analysis and recommendations (paragraphs 14–85).

3. This paper also includes one appendix: Appendix A—Illustrative Examples.

Summary of staff recommendations

4. We recommend that any amendment specify that a currency is exchangeable if an entity would be able to exchange that currency for another currency at a specified

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date. Accordingly, exchangeability of a currency is lacking when an entity would be unable to exchange a currency for another currency at a specified date.

5. Furthermore, we recommend that any amendment specify 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. Furthermore, we recommend that any amendment not provide application guidance on what constitutes 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 it can legally access.

   (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 unable to obtain 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.

Background

6. Paragraph 8 of IAS 21 includes the following definitions:

> …Closing rate is the spot exchange rate at the end of the reporting period…
>
> …Exchange rate is the ratio of exchange for two currencies…
>
> …Spot exchange rate is the exchange rate for immediate delivery.

7. When an entity reports foreign currency transactions in the functional currency, IAS 21 requires the entity to use:

   (a) the spot exchange rate (as defined in paragraph 8 of IAS 21) (spot rate) between the functional currency and the foreign currency at the date of the transaction on initial recognition; and

   (b) the closing rate (as defined in paragraph 8 of IAS 21) when translating foreign currency monetary items at the end of each reporting period.

8. When an entity uses a presentation currency other than the functional currency, IAS 21 requires the entity to translate:

   (a) assets and liabilities at the closing rate, and income and expenses at the exchange rates at the dates of the transactions (if the functional currency is not the currency of a hyperinflationary economy). We think the exchange rate at the date of the transaction is the spot rate on that date—this is because it is only the spot rate that would reflect the exchange rate at that date; and

   (b) all items (ie assets, liabilities, equity items, income and expenses) at the closing rate if the functional currency is that of a hyperinflationary economy.

9. When exchangeability of a currency is lacking, an entity is unable to exchange that currency for another currency. The absence of exchange transactions means that an entity cannot observe a spot rate (ie neither a closing rate nor the exchange rate at the date of a transaction). Accordingly, whenever a currency is not exchangeable, there is no observable spot rate for the currency.

10. Paragraph 26 of IAS 21 includes requirements in relation to a lack of exchangeability but only for foreign currency transactions reported in the functional currency. This paragraph states:

> …If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

11. IAS 21 does not say anything further about exchangeability. It neither specifies circumstances in which exchangeability is temporarily lacking, nor provides requirements for a lack of exchangeability that is other than temporary.

12. At its meetings in 2018, the Committee considered the exchange rate to use when there is a long-term lack of exchangeability, and published an Agenda Decision in September 2018. Our analysis of that matter indicated that many factors influence a currency's exchangeability and, thus, it is complex to assess.

13. The following paragraphs analyse those factors in considering how to define exchangeability (and a lack of exchangeability).

Staff analysis and recommendations

Defining exchangeability

14. IAS 21 does not specify when a currency is exchangeable. For the purpose of applying IAS 21, we think a currency is exchangeable if an entity would be able to exchange that currency for another currency at a specified date. Accordingly, exchangeability is lacking when an entity would be unable to exchange a currency for another currency at a specified date.

15. To operationalise the definition proposed above, any amendment would need to specify when an entity is 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?

Staff analysis

16. In assessing whether a currency is exchangeable, we think 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.

17. As mentioned above, IAS 21 defines a spot rate as ‘the exchange rate for immediate delivery’. Accordingly, we think when an entity assesses exchangeability and uses a spot rate, the entity would consider whether it could obtain immediate delivery of the other currency.

18. We acknowledge that 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.

19. 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 a delay would depend on the facts and circumstances. We think the notion of ‘immediate delivery’ includes this type of delay. Ignoring administrative delays would, in our view, lead to entities concluding that exchangeability is lacking

when there is no genuine lack of exchangeability. We think it would be useful to specify this in any amendment.

20. We also recommend 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.

21. Paragraphs A3–A4 of Appendix A illustrate our analysis in this respect.

How we responded to Committee feedback

22. Some Committee members said our preliminary definition of a lack of exchangeability[1] did not appear to capture situations in which an entity is able to obtain foreign currency through an administrative process, but that process creates some delay.

23. We agree with those Committee members. Our analysis in paragraphs 16–21 above incorporates this feedback.

Staff recommendation

24. We recommend that any amendment:

    (a) specify that the assessment of exchangeability includes consideration of whether an entity 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 provide application guidance on what would constitute a normal administrative delay.

[1] An entity's inability to exchange a currency for immediate delivery of another currency.

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

Staff analysis

25. As outlined in paragraph 14 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.

26. 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 might 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.

27. We think 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.

28. Paragraphs A5–A8 of Appendix A illustrate our analysis in this respect.

How we responded to Committee feedback

29. Committee members did not express concerns about our preliminary view on this aspect of exchangeability.

30. However, we received informal feedback suggesting that consideration of an entity's ability to obtain foreign currency include both its legal and practical ability. When jurisdictional authorities administer a currency's exchangeability, an entity might have the right to access an exchange mechanism but be unable to obtain foreign currency because of unusual administrative delays.

31. Our recommendation in Question 1 above would address concerns about the existence of administrative delays (see paragraphs 16–24 of this paper). We therefore think any amendment need not explicitly discuss the practical ability to obtain foreign currency.

Staff recommendation

32. Consistent with our preliminary view, we recommend that in assessing exchangeability (or a lack thereof), an entity consider 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?

Staff analysis

33. When assessing whether a currency is exchangeable, we think an entity should consider only exchange mechanisms or markets that it can legally access. This is because only those mechanisms or markets create enforceable rights and obligations. The assessment of whether an entity can legally access an exchange mechanism or market depends on the particular facts and circumstances.

34. When the exchangeability of a currency is administered by jurisdictional authorities, there are often 'parallel markets' through which an entity might be able to obtain foreign currency. We think an entity considers those markets in assessing whether a currency is exchangeable only if it can legally access those markets. If a market is not legally accessible, transactions within that market are unlikely to be enforceable.

35. Paragraphs A9–A12 of Appendix A illustrate our analysis in this respect.

How we responded to Committee feedback

36. Our preliminary view was that an entity would consider all exchange mechanisms or markets to which it is not legally prevented from having access—we said an entity should not consider a market if jurisdictional authorities prohibit the existence of such a market and enforce such a prohibition.

37. Some Committee members disagreed with this preliminary view. They said an entity should consider only legal markets and disregard illegal markets, regardless of whether jurisdictional authorities enforce prohibitions against illegal markets.

38. In the light of those comments, we have revisited our preliminary view. Our recommendation does not refer to enforceability of prohibitions against illegal markets.

Staff recommendation

39. We recommend that in assessing exchangeability (or a lack thereof), an entity considers only markets or exchange mechanisms that it can legally access.

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

Staff analysis

Why does this matter?

40. 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.

41. 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.

42. 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 41(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?

43. 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

44. 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 think an entity should 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.

45. 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[2]. Our recommendation would therefore align with the requirements in paragraph 26. Applying our recommendation, an entity might conclude that a currency is exchangeable for some transactions or balances, but not exchangeable for others.

46. Paragraphs A13–A15 of Appendix A illustrate our analysis in this respect.

Using a presentation currency other than the functional currency

47. 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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[2] 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...'

48. We think 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 the requirements in paragraphs 38–49 of IAS 21:

    (a) refer to the 'results and financial position' of the entity or foreign operation.

    (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.

49. 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'.

50. Accordingly, when using a presentation currency other than the functional currency (and translating the results and financial position of a foreign operation), we think 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).

51. 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.[3]

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

[3] We think 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, we think an entity would apply judgement in determining the applicable rate.

53. 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.

54. Paragraphs A13–A14 and A16–A17 of Appendix A illustrate our analysis in this respect.

How we responded to Committee feedback

55. Committee members generally agreed that an entity considers the purpose for which it obtains foreign currency when assessing exchangeability (or a lack thereof). We discuss below Committee members' comments on parts of our preliminary analysis.

Using several exchange rates for a currency

56. Two Committee members said our preliminary view could result in entities possibly using several exchange rates when reporting foreign currency transactions or translating financial statements. This could, in their view, create implementation challenges because reporting systems might not be set up to manage several exchange rates for one currency.

57. As explained in paragraph 45 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, we think our recommendation would not create any new implementation challenges.

Potential effects of our proposed approach

58. One Committee member said entities might 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 this could result in identifying a broad scope of currencies that are not exchangeable.

59. We think 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'. Nonetheless, we agree that if the delay exceeds a normal administrative delay then this could result in an entity concluding that a currency is not exchangeable.

60. We also note the interaction between this factor and our recommendation regarding the exchange rate discussed in Agenda Paper 14B for this meeting. Based on our recommendations in that paper, assessing that a currency is not exchangeable would not automatically result in the use of an estimation technique—in several situations, an entity could still consider using an observable rate.

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

61. One Committee observer said 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.

62. In addition, one Committee member said an entity might be unable to recover its entire net investment in a foreign operation in a single transaction. This member suggested that any amendment consider an entity's ability to recover the net investment over time (such as through dividend-remittances over several years).

63. Paragraphs 47–53 of this paper explain why we think an entity should 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. We think that approach is consistent with the requirements in IAS 21.

64. 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.

65. Nonetheless, we think concerns on this matter would be mitigated because, in Question 5 (see paragraphs 67–83 of this paper), we consider situations in which an entity can obtain only some amounts of foreign currency. Our recommendation in that section is that an entity would consider a currency to be exchangeable if it can

obtain more than an insignificant amount of foreign currency. Applying our 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

66. 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?

Staff analysis

67. 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 a legal 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)?

68. We think there are four possible alternatives to consider in this respect. A currency would be exchangeable if, for a particular purpose[4], an entity is able to obtain:

    (a) even an insignificant amount of foreign currency (Alternative I);

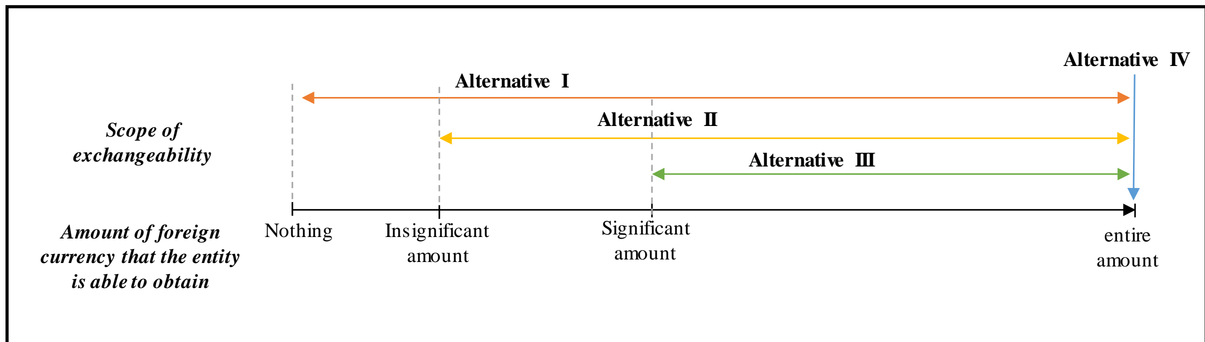
    (b) more than an insignificant amount of foreign currency (Alternative II)

[4] Paragraphs 40–66 of this paper discuss the purpose of obtaining foreign currency.

(c) more than a significant amount of foreign currency (Alternative III); or

(d) the entire amount of foreign currency (Alternative IV).

69. The diagram below illustrates the proposed alternatives for exchangeability:



70. Accordingly, a currency would *not* be exchangeable if, for a particular purpose, an entity is unable to obtain:

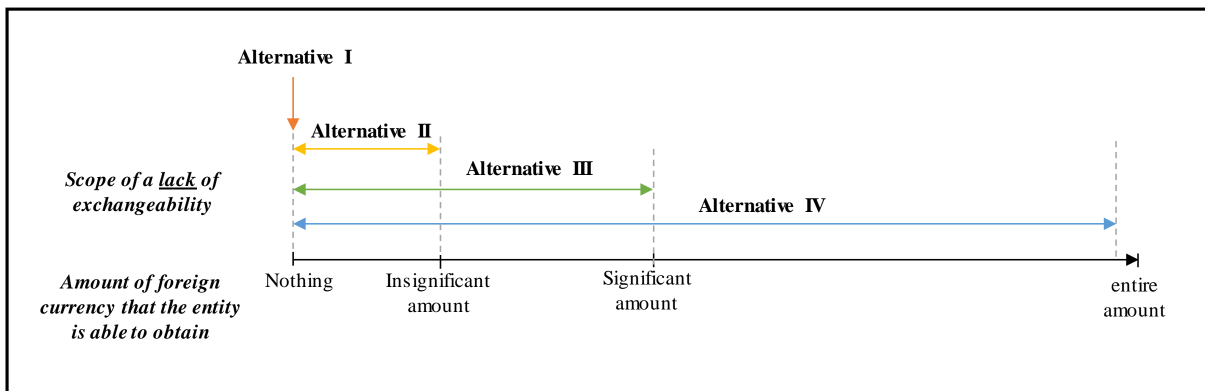
(a) any amount of foreign currency (Alternative I);

(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).

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



72. 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).

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

Reporting foreign currency transactions in the functional currency

74. Consistent with our analysis in paragraphs 44–46 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.

75. Applying the alternatives described above in paragraph 68 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

76. Consistent with our analysis in paragraphs 47–54 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).

77. For example, assume that a reporting entity has a foreign operation. Applying the alternatives described above in paragraph 68, 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

78. We think 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 the 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 that the Committee not consider these options further.

79. In considering Alternative II or Alternative III, we recommend Alternative II (ie exchangeability is lacking when an entity is unable to obtain 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. Previous Committee discussions indicate that Committee members were of the 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 14B. 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.

How we responded to Committee feedback

80. Committee members generally agreed that Alternative II would be appropriate when an entity is able to exchange only some amounts of foreign currency.

81. Nonetheless:

(a) one Committee member said there was no conceptual basis for choosing Alternative II over the other alternatives; and

(b) two Committee members expressed a preference for Alternatives III or IV, because, in their view, those approaches would more faithfully reflect the

amount at which assets and liabilities could be settled had exchangeability not been lacking.

82. We agree there is limited conceptual basis for selecting either Alternative II or Alternative III. Neither IAS 21, nor the 2018 *Conceptual Framework for Financial Reporting*, provide principles or requirements that could help the Committee consider which alternative is more appropriate from a conceptual perspective. Nonetheless, for the reasons outlined in paragraph 79 of this paper, we continue to think Alternative II would be more appropriate. In our view, this alternative strikes a balance between the scope of any amendment and providing a faithful representation of the information reported.

Staff recommendation

83. 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 unable to obtain more than an insignificant amount of foreign currency.

Staff recommendations

84. Based on our analysis, we recommend that any amendment specify 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 a currency for another currency at a specified date.

85. Furthermore, we recommend that any amendment specify 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. Furthermore, we recommend that any amendment not provide application guidance on what constitutes 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 it can legally access.

(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 unable to obtain more than an insignificant amount of foreign currency.

Question for the Committee

Does the Committee agree with our recommendations in paragraphs 84–85? If not, what would the Committee recommend and why?

Appendix A—Illustrative Examples

A1. This appendix sets out examples that illustrate how an entity would assess exchangeability considering the factors discussed in paragraphs 16–83 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. We assume in this example 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. Accordingly, Entity Y considers 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.

Entity's intention to exchange a currency

A5. We assume in this example 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 into an exchange transaction through the official exchange mechanism (we assume there are no other exchange mechanisms that Entity Y can access).

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 25–32, Entity Y's management 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. We assume in this example 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 are not legal. There is no other exchange mechanism or market that Entity Y can legally access.

A11. As explained in paragraphs 33–39 of this paper, Entity Y considers only exchange mechanisms or markets that it can legally access in assessing whether LC is exchangeable.

A12. Because Entity Y cannot legally enter into transactions with individual resellers, it would not consider this exchange market when it assesses whether LC is exchangeable. Because there is no other legally accessible exchange mechanism or market, Entity Y would conclude that exchangeability of LC is lacking.

Purpose of obtaining foreign currency

A13. We assume in this example 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 following:

(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 to 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 unable to obtain 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.