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Project	Lack of exchangeability (IAS 21)		
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Introduction and purpose

1. Agenda Paper 8 explains the background to this research work undertaken regarding IAS 21.

2. This paper presents our analysis and views on whether, and how, to:

   (a) define exchangeability and, consequently, a lack of exchangeability; and

   (b) specify when a lack of exchangeability is temporary or long-term.

3. As a reminder, we are asking IFRS Interpretations Committee (Committee) members for advice and feedback on our analysis and preliminary views. We are not asking the Committee to make decisions.

Structure

4. This paper includes:

   (a) summary of our preliminary views (paragraphs 6–8);

   (b) background information (paragraphs 9–16);

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(c) our analysis and preliminary views on defining:

(i) exchangeability and a lack of exchangeability (paragraphs 17–60); and

(ii) a temporary and long-term lack of exchangeability (paragraphs 60–66).

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

Summary of our preliminary views

Exchangeability (and a lack of exchangeability)

6. Our preliminary view is that a currency would be exchangeable into another currency if an entity is able to exchange that currency for immediate delivery of another currency at a specified date. Accordingly, a lack of exchangeability would exist when an entity is unable to exchange a currency for immediate delivery of another currency at a specific date.

7. We think that in assessing exchangeability (or a lack of exchangeability) an entity:

(a) would consider its ability to obtain foreign currency, and not its intention (or decision) to do so.

(b) would consider all exchange mechanisms or markets to which it is not legally prevented from having access.

(c) would 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).

(d) in circumstances in which it is able to obtain only some amounts of foreign currency, would conclude that a lack of exchangeability exists 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 FC 1,000 into its functional currency, assume an entity is able to obtain an amount of foreign currency of only FC 400 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, accordingly, would conclude that the currency is exchangeable for this particular purpose.

Temporary and long-term lack of exchangeability

8. Our preliminary view is that:

    (a) a temporary lack of exchangeability would exist when:

        (i) a currency is not exchangeable at the end of the reporting period, thus preventing the reporting entity from observing a spot rate; but

        (ii) the exchangeability of the currency is restored after the end of the reporting period and before the date on which the financial statements are authorised for issue.

    (b) a long-term lack of exchangeability would be a lack of exchangeability that is other than temporary

Background

9. 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.

10. 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) 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) when translating foreign currency monetary items at the end of each reporting period.

11. 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 exchange rate (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.

12. The circumstances in which a currency is subject to a lack of exchangeability[1] results in an entity being unable to exchange that currency for another currency. The absence of an exchange transaction means that an entity cannot observe a spot rate. Accordingly, whenever a currency is not exchangeable, there is no observable spot rate for the currency.

13. 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.

14. IAS 21 does not say anything further about exchangeability. It does not specify circumstances in which exchangeability is temporarily lacking, nor does it provide requirements for a lack of exchangeability that is other than temporary.

15. In June and September 2018, the Committee considered the matter of the determination of the exchange rate when there is a long-term lack of exchangeability,

[1] Throughout this paper, for ease of reference, we refer to 'a currency's exchangeability' or 'lack of exchangeability'. IAS 21 refers to the exchangeability between two currencies.

and published an Agenda Decision in September. Our analysis of this matter indicates that a currency's exchangeability is, in practice, a concept encompassing many features and thus is complex to assess.

16. The following paragraphs discuss the concept and those features.

Exchangeability (and a lack of exchangeability)

Staff analysis

17. 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 immediate delivery of another currency at a specified date. Accordingly, a lack of exchangeability would exist when an entity is unable to exchange a currency for immediate delivery of another currency at a specified date.[2]

18. The notion of 'immediate delivery' in any proposed definition of exchangeability (or lack thereof) is important because it aligns with the definition of a spot rate in paragraph 8 of IAS 21 (see paragraph 9 of this paper). IAS 21 generally requires an entity to use the spot rate when translating foreign currency amounts or transactions as explained in paragraphs 10–11 of this paper.[3]

19. To operationalise the definition proposed above in paragraph 14, any proposed requirements would need to specify circumstances in which an entity is able to obtain foreign currency (ie circumstances in which exchangeability exists) and, consequently, circumstances in which there is a lack of exchangeability. To identify those circumstances, we considered the following questions:

    (a) what if an entity is able, but does not intend, to exchange a currency? (Question 1)

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[2] For ease of reference, we refer to 'an entity's ability or inability to exchange a currency for immediate delivery of another currency' as 'an entity's ability or inability to obtain foreign currency' throughout the rest of this paper.

[3] As discussed in paragraphs 18–19 of Agenda Paper 8 for this meeting, we think the Committee should not reconsider any fundamental requirements in IAS 21 as part of this project. Consequently, in considering any possible new requirements for IAS 21 we have not reconsidered the existing requirement to use a spot rate—this means an entity cannot use forward exchange rates or rates that it expects will apply in the future. Reconsidering the requirement to use a spot rate would significantly broaden the scope of any project.

(b) which means of accessing foreign currency does an entity consider? (Question 2)

(c) what is the purpose for which an entity obtains foreign currency? (Question 3) and

(d) what if an entity is able to exchange only some amounts of foreign currency? (Question 4)

Question 1: what if the entity is able, but does not intend, to exchange a currency?

20. As outlined in paragraph 14 of this paper, assessing whether a currency is exchangeable for another currency depends on an entity's ability to obtain foreign currency. This requires an entity-specific assessment of the facts and circumstances.

21. It is possible for entities in the same jurisdiction to reach different conclusions on 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 because they enter into particular transactions (importing food, medicines, etc.) while other entities that do not enter into such transactions would not.

22. An entity's intentions or decisions regarding the exchange of a currency would not be relevant to the assessment of exchangeability. For example, a currency would be exchangeable if an entity is able to obtain foreign currency even if it decides not to do so.

23. In our view, a lack of exchangeability generally arises when laws, regulations or specific controls prevent an entity from being able to obtain foreign currency. Such restrictions could deprive an entity of the *ability* to access foreign currency.

24. Appendix A to this paper illustrates our analysis.

Question 2: which means of accessing foreign currency does an entity consider?

25. When assessing whether a currency is exchangeable, we think an entity should consider all exchange mechanisms or markets to which the entity is not legally prevented from having access. This is because those mechanisms or markets

generally create enforceable rights and obligations. The assessment of whether an entity is legally prevented from accessing an exchange mechanism or market would depend on the particular facts and circumstances.

26. 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. If the jurisdictional authorities prohibit the existence of such markets and enforce such a prohibition, we think an entity should not consider these ‘parallel markets’ in assessing whether a currency is exchangeable. Any transactions in these prohibited markets could be reversed.

27. Appendix A to this paper illustrates our analysis.

Question 3: what is the purpose for which an entity obtains foreign currency?

Why does this matter?

28. In some jurisdictions, particularly where exchange rates are determined through market forces, there is generally 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. However, in other jurisdictions, particularly where jurisdictional authorities administer foreign exchange 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) while encouraging imports of goods. In such circumstances, the jurisdictional authorities may:

    (a) set a preferential rate for imports of goods and a ‘penalty rate’ for dividend remittances, 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 pay dividends abroad.

29. Accordingly, the assessment of whether an entity is able to obtain foreign currency could depend on the purpose for which it obtains that foreign currency. For example, in the situation described above in paragraph 17(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 use of foreign currency?

30. 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. Accordingly, we considered these separately in our assessment.

Reporting foreign currency transactions in the functional currency

31. 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 the monetary and non-monetary items relating to those foreign currency 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.

32. Our proposal would align with the requirements in paragraph 26 of IAS 21 (*emphasis added*):

> When several exchange rates are available, the rate used is that at which the future cash flows represented by *the transaction or the balance* could have been settled if those cash flows had occurred at the measurement date...

33. Applying our preliminary view, an entity might conclude that a currency is exchangeable for some transactions or balances, but not exchangeable for others.

34. Appendix A to this paper illustrates our analysis.

Using a presentation currency other than the functional currency

35. 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 for inclusion in its consolidated financial statements.

36. 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) of IAS 21) without distinguishing between monetary or non-monetary items or changing the underlying measurement of those assets and liabilities.

37. 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'.

38. 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 its 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 the entity's net assets or the net investment in the foreign operation—therefore, the entity would assess whether it is able to obtain foreign currency to realise its net assets (or its net investment in the foreign operation).

39. The net assets or net investment might be realised by:

(a) distributing a financial return to the entity's owners, or earning a financial return on the net investment (through dividend remittances or similar payments); or

(b) recovery by the entity's owners of their investment or disposing of the net investment.[4]

[4] 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.

40. As reported in Agenda Paper 2 for the Committee's June 2018 meeting, 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 preliminary view would align with this practice.

41. Appendix A to this paper illustrates our analysis.

US GAAP

42. Our analysis of the exchange rate an entity uses to translate the results and financial position of a foreign operation also aligns with the requirements in US GAAP.

43. Topic 830 *Foreign Currency Matters* includes requirements that are similar to those in IAS 21 regarding the translation of financial statements into the reporting currency. Paragraph 30-45-6 of Topic 830 states:

> In the absence of unusual circumstances, the exchange rate applicable to conversion of a currency for purposes of dividend remittances shall be used to translate foreign currency statements.

44. Paragraph 138 of FAS 52 *Foreign Currency Translation* (the Standard preceding Topic 830) explains the FASB's rationale (*emphasis added*):

> The Board has concluded that if multiple rates exist, the rate to be used to translate foreign statements should be, in the absence of unusual circumstances, the rate applicable to dividend remittances. *Use of that rate is more meaningful than any other rate because cash flows to the reporting enterprise from the foreign entity can be converted at only that rate, and realization of a net investment in a foreign entity will ultimately be in the form of cash flows from that entity.*

Question 4: what if an entity is able to exchange only some amounts of foreign currency?

45. 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 legally permitted exchange mechanism. It may not be clear whether the entity would consider the currency to be

exchangeable (because it is able to obtain some amounts of foreign currency) or not exchangeable (because it is unable to obtain all foreign currency required to settle that liability).

46. We think there are four possible alternatives to consider in this respect. A currency would be exchangeable if, for a particular purpose[5], an entity is able to obtain:

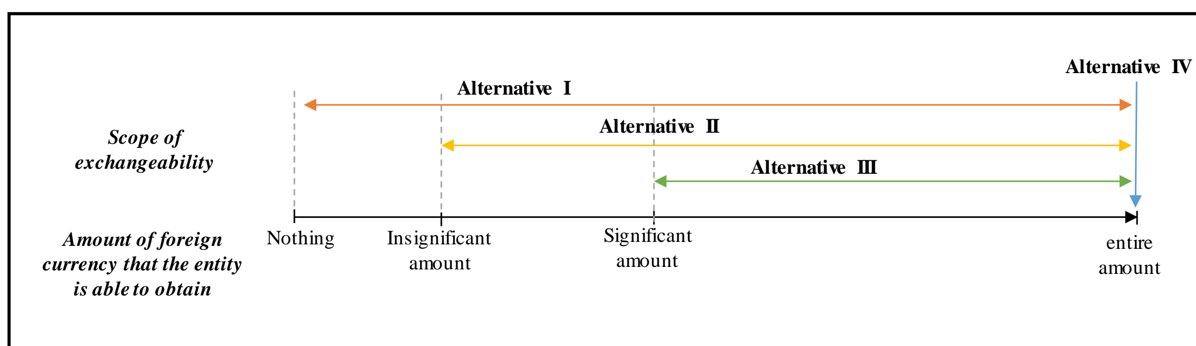
(a) even an insignificant amount of foreign currency (Alternative I);

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

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

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

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



48. Accordingly, a currency would be subject to a *lack of* exchangeability if, for a particular purpose, an entity is unable to obtain:

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

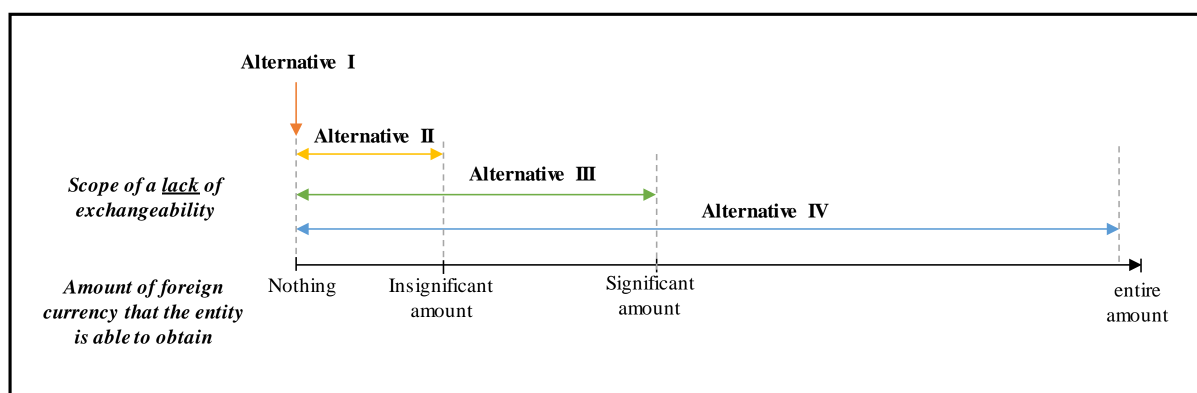
(b) more than an insignificant amount of foreign currency (Alternative II);

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

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

[5] See paragraphs 28–44 of this paper for discussion about the purpose of the foreign currency.

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



50. This diagram shows that Alternative I would result in the narrowest set of circumstances in which a lack of exchangeability would exist. This is because, applying Alternative I, there would be a lack of exchangeability 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 a lack of exchangeability would exist. This is because, applying Alternative IV, there would be a lack of exchangeability 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).

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

Reporting foreign currency transactions in the functional currency

52. Consistent with our analysis in paragraphs 31–34 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.

53. Applying the alternatives described above in paragraph 49 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 such an asset or liability (Alternative II);

(c) more than a significant amount of foreign currency required to settle such an asset or liability (Alternative III); or

(d) the entire amount of foreign currency required to settle such an asset or liability (Alternative IV).

Using a presentation currency other than the functional currency

54. Consistent with our analysis in paragraphs 35–44 of this paper, the purpose of obtaining foreign currency in this situation would be the realisation of an entity's net assets (or its net investment in a foreign operation if translating the results and financial position of that foreign operation).

55. For example, assume that a reporting entity has a foreign operation. Applying the alternatives described above in paragraph 49, 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 portion of its net investment in the foreign operation (Alternative I);

(b) more than an insignificant portion of its net investment in the foreign operation (Alternative II);

(c) more than a significant portion of its net investment in the foreign operation (Alternative III); or

(d) all of its net investment in the foreign operation (Alternative IV).

Comparison of the alternatives

56. We think Alternative I (ie situations in which a lack of exchangeability exists 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 situations in which a lack of exchangeability exists when an entity cannot obtain the entire amount of foreign currency) would lead to many situations being captured within the scope of any proposed requirements, which could lead to some unintended consequences. Accordingly, we would recommend not considering these options further.

57. In considering Alternative II or Alternative III, our preliminary view is Alternative II (ie a lack of exchangeability exists 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. The Committee's discussion on this topic at its June 2018 meeting indicated that Committee members were of the view that any possible requirements developed 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 to apply discussed in Agenda Paper 8B. Our preliminary view in that paper regarding the exchange rate is to require the use of an estimated rate when there is a long-term lack of exchangeability. We see benefits in narrowing the circumstances in which an entity would apply an estimated rate.

Conclusion

58. Based on our analysis, we think for situations in which an entity is able to obtain only some amounts of foreign currency, a lack of exchangeability exists when, for a particular purpose, an entity is unable to obtain more than an insignificant amount of foreign currency.

Preliminary views

59. Based on our analysis, our preliminary view is that a currency would be exchangeable into another currency if an entity is able to exchange that currency for immediate delivery of another currency at a specified date. Accordingly, a lack of exchangeability would exist when an entity is unable to exchange a currency for immediate delivery of another currency at a specific date.

60. We think that in assessing exchangeability (or a lack of exchangeability) an entity:

    (a) would consider its ability to obtain foreign currency, and not its intention (or decision) to do so.

    (b) would consider all exchange mechanisms or markets to which it is not legally prevented from having access.

(c) would 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).

(d) in circumstances in which it is able to obtain only some amounts of foreign currency, would conclude that a lack of exchangeability exists when, for a particular purpose, it is unable to obtain more than an insignificant amount of foreign currency.

Question 1 for the Committee

Does the Committee have any advice or feedback on our analysis of, and preliminary views on, the definition of exchangeability outlined in paragraphs 14–60?

Temporary and long-term lack of exchangeability

Staff analysis

61. In this section, we consider how any proposed requirements might distinguish between a temporary lack of exchangeability and a long-term lack of exchangeability.

Temporary lack of exchangeability

62. Paragraph 26 of IAS 21 states:

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

63. Paragraph 26 of IAS 21 does not explicitly define 'temporarily'. However, the requirement for an entity to use the first subsequent rate at which exchanges could be made implies that a temporary lack of exchangeability arises when:

    (a) a currency is not exchangeable at the end of the reporting period (reporting date), thus preventing the reporting entity from observing a spot rate at that date; but

    (b) the exchangeability of the currency is restored after the reporting date and before the date on which the financial statements are authorised for issue.

64. We considered other possible definitions of a temporary lack of exchangeability. For example, some might say that a temporary lack of exchangeability should be no more than a period of a few days or weeks. However, we think a temporary lack of exchangeability should be defined in a manner that is consistent with the requirements in paragraph 26 of IAS 21. This is because such a definition:

    (a) is simple to apply; and

    (b) results in minimal changes to IAS 21, which is more consistent with the objective of a narrow-scope project.

Long term lack of exchangeability

65. A long-term lack of exchangeability could be defined simply as a lack of exchangeability that is other than temporary.

66. Applying this definition, a long-term lack of exchangeability would arise only in circumstances in which the currency is not exchangeable at the reporting date and its exchangeability is not restored by the date on which the financial statements are authorised for issue.

Preliminary views

67. Our preliminary view is that:

    (a) a temporary lack of exchangeability would be a situation in which:

        (i) a currency is not exchangeable at the end of the reporting period, thus preventing the reporting entity from observing a spot rate; but

(ii) the exchangeability of the currency is restored after the end of the reporting period and before the date on which the financial statements are authorised for issue.

(b) a long-term lack of exchangeability would be a lack of exchangeability that is other than temporary.

Question 2 for the Committee

Does the Committee have any advice or feedback on our analysis and our preliminary views on a temporary and a long-term lack of exchangeability outlined in paragraphs 61–67?

Appendix A—Illustrative Examples

A1. This appendix sets out examples that illustrate how an entity would assess exchangeability considering the factors discussed in paragraphs 20–44 of this paper.

A2. Throughout the examples below, we consider:

(a) Entity X, a reporting entity, whose functional and presentation currency is 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.

Entity's intention to exchange a currency

A3. We assume in this example that the jurisdictional authorities specify one official exchange rate. The official exchange rate is GBP 1: LC 5. The jurisdictional authorities do not restrict access to GBP at this rate.

A4. 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 GBP 1: LC 25 would faithfully reflect those economic conditions.

A5. 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 is devalued. Accordingly, Entity Y does not intend to enter into an exchange transaction through the legal exchange mechanism (we assume there are no other exchange mechanisms that Entity Y can access).

A6. 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 20–24 of this paper, 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 does not lack exchangeability for that particular purpose.

Means of accessing foreign currency

A7. 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.

A8. The jurisdictional authorities previously had exclusive responsibly for allocating foreign currency within the jurisdiction. In the absence of a legal exchange mechanism, individual resellers settle exchange transactions at an exchange rate not set by the jurisdictional authorities. Transactions with those resellers are legally prohibited and the authorities enforce sanctions against the resellers. Accordingly, any exchange transaction entered into with those resellers could be reversed. There is no other exchange mechanism or market that Entity Y could access.

A9. As explained in paragraphs 25–27 of this paper, Entity Y assesses whether LC is exchangeable and, thus, assesses the exchange mechanisms or markets to which it is not legally prevented from having access.

A10. Because Entity Y is legally prevented from entering into transactions with individual resellers, it would not consider this exchange market when it assesses whether LC is exchangeable. Because there is no other accessible exchange mechanism or market, Entity Y would conclude that there is a lack of exchangeability for LC.

Purpose of obtaining foreign currency

A11. We assume in this example that LC is exchangeable for imports of goods and services, but restrictions prevent Entity Y from being able to obtain foreign currency to remit dividends or recover investments.

A12. The official exchange rates applicable for imports of goods and services at the reporting date are as following:

(a) a preferred rate of GBP 1: LC 5 for imports of food and medicines; and

(b) a rate of GBP 1: LC 50 for imports of other goods and services.

Assessing exchangeability

Entity Y reports foreign currency transactions in its functional currency

A13. 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 this trade payable were to occur at the reporting date—ie a spot rate of GBP 1: LC 50. 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

A14. Entity X would translate the results and financial position of Entity Y using the exchange rate that applies to realising its net investment in Entity Y.

A15. In this situation, there is a lack of exchangeability of LC. This is because, at the reporting date, Entity Y is unable to obtain foreign currency to enable Entity X to realise its net investment in Entity Y. In other words, LC is subject to a lack of exchangeability 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.