Lack of exchangeability

Talking points for episode 110

In some situations, governments may restrict access to foreign currency. Although these circumstances might arise relatively infrequently, when they do arise economic conditions can deteriorate rapidly. As a result, the issue of lack of exchangeability, when it arises, is urgent and relevant for everyone with an interest in that economy including local entities and foreign investors and creditors.

The main challenge in in such circumstances is to determine the exchange rate. IAS 21 does not specify what an entity is required to do when a lack of exchangeability is not temporary. The IASB's Exposure draft of amendments to IAS 21 proposes amendments in two steps, as follows:

Step I - Assessing whether there is an exchangeability between two currencies
A currency is exchangeable into another currency at a measurement date when an entity is **able to exchange that currency for the other currency** within a **time frame** that includes a normal administrative delay and through a **market or exchange mechanism** in which the exchange transaction would create enforceable rights and obligations. Exchangeability is lacking when, for a particular purpose, the entity is able to obtain no more than an **insignificant amount of foreign currency.**

Step II - Determining the spot exchange rate when exchangeability is lacking
The estimated spot exchange rate must meet the following fundamental conditions assessed at the measurement date:

- a rate at which an entity would have been able to enter into an exchange transaction had the currency been exchangeable into the other currency;
- a rate that would have applied to an orderly transaction between market participants; and
- a rate that faithfully reflects the prevailing economic conditions

When exchangeability is lacking the ED proposes to determine the spot exchange rate by using one of three techniques:

1) Using an observable exchange rate
2) Using the first subsequent exchange rate
3) Using an estimation technique to determine the spot exchange rate

The ED also sets out proposed disclosure and transition requirements.

We believe that most of the countries dealing with lack of exchangeability will welcome the proposals. However, there are questions on the application of the model and the significant judgments involved.

Comments on the exposure draft are due to be received by 1 September 2021.

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