KPMG

Lack of exchangeability

17 May 2021 (updated 24 August 2023)

Global IFRS Institute

Mahesh Narayanasami
Partner
KPMG US, DPP New York

Final amendments address when and how to estimate a spot rate

Highlights

- **Assessing exchangeability: When to estimate a spot rate**
- **Estimating a spot rate: Meeting the estimation objective**
- **New disclosure requirements**
- **Effective from 1 January 2025**

Under IAS 21 *The Effects of Changes in Foreign Exchange Rates*, a company uses a spot exchange rate when translating a foreign currency transaction.

However, in rare cases, it is possible that one currency cannot be exchanged into another. This lack of exchangeability might arise when a government imposes controls on capital imports and exports, for example, or when it provides an official exchange rate but limits the volume of foreign currency transactions that can be undertaken at that rate. Consequently, market participants are unable to buy and sell currency to meet their needs at the official exchange rate and turn instead to unofficial, parallel markets.

Although few jurisdictions are affected by this, it can have a significant accounting impact for those companies affected.

In August 2023, the International Accounting Standards Board (IASB) amended IAS 21 to clarify:

- when a currency is exchangeable into another currency; and
- how a company estimates a spot rate when a currency lacks exchangeability.

Assessing exchangeability: When to estimate a spot rate

A currency is exchangeable into another currency when a company is able to exchange that currency for the other currency at the measurement date and for a specified purpose. When a currency is not exchangeable, a company needs to estimate a spot rate.

Estimating a spot rate: Meeting the estimation objective

A company's objective when estimating a spot rate is only that it reflects the rate at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic conditions. The amendments contain no specific requirements for estimating a spot rate.

Therefore, when estimating a spot rate a company can use:

- an observable exchange rate without adjustment; or
- another estimation technique.

Using an observable rate

A company can use an observable rate if that rate meets the estimation objective – i.e. the rate reflects that at which an orderly exchange transaction would take place at the measurement date between market participants under prevailing economic conditions.

When making this assessment, a company needs to consider:

- whether several observable exchange rates exist;
- the purpose for which the currency is exchangeable;
- the nature of the exchange rate; and
- the frequency with which exchange rates are updated.

Examples of an observable exchange rate include the following.

- A spot exchange rate for a purpose other than that for which the company is assessing exchangeability.
- The first exchange rate at which a company is able to obtain the other currency for its specified purpose after exchangeability is restored. If a company opts to use this rate as an observable rate, then it would also need to consider the time elapsed between the measurement date and the date at which exchangeability is restored, as well as inflation rates.

Using another estimation technique

When estimating a spot rate, a company may use **any** observable exchange rate and adjust it as necessary. This includes using rates from exchange transactions in markets or exchange mechanisms that do not create enforceable rights and obligations. However, the technique used needs to meet the estimation objective.

New disclosure requirements

Under the amendments, companies will need to provide new disclosures to help users assess the impact of using an estimated exchange rate on the financial statements. These disclosures might include:

- the nature and financial impacts of the currency not being exchangeable;
- the spot exchange rate used;
- the estimation process; and
- risks to the company because the currency is not exchangeable.

Effective from 1 January 2025

The amendments apply for annual reporting periods beginning on or after 1 January 2025. Earlier application is permitted.

Publication name: *Lack of exchangeability*

Publication date: August 2023

kpmg.com/ifrs