KPMG

Lack of exchangeability

Global IFRS Institute

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Addressing when a currency is exchangeable and estimating an exchange rate when it is not

Highlights

- Proposals aim to clarify when and how to estimate a rate
- Improving transparency through additional disclosures
- Feedback summary and next steps

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 a currency cannot be exchanged into another currency due to a lack of exchangeability. This 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.

"Applying IFRS® Standards is about presenting a true and fair view. The exposure draft offers nothing less in proposing that companies use an exchange rate based on their best estimate rather than using an inaccessible official rate."

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During its January 2022 meeting, the International Accounting Standards Board (the Board) discussed a summary of the feedback on its **exposure draft** (ED) issued in April 2021. It will analyse the feedback and provide recommendations on the project direction at future meetings.

The Board's exposure draft sets out:

- when a currency is exchangeable into another currency – i.e. a company is able to actually exchange that currency for the other currency at the measurement date; and
- how a company determines an estimated spot rate when a currency lacks exchangeability.

When determining an estimated spot rate, a company could use an observable exchange rate, but only if it meets the criteria set out in the ED – e.g. if it is available only for some purposes, or if it is a subsequent rate that is restored after exchangeability was lacking only temporarily. Alternatively, the company would need to estimate a spot exchange rate that meets specific conditions.

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The proposals' application guidance introduces a **two-step approach** (PDF 82 KB) for companies to apply when determining whether a currency is exchangeable (Step 1) and when estimating a spot exchange rate (Step 2).

Improving transparency through additional disclosures

The ED proposes some new disclosures to help users assess the impact of using an estimated exchange rate on the financial statements. Those companies that use an estimated rate because of a lack of exchangeability would need to disclose, for example:

- the estimation technique applied and information about the inputs used;
- qualitative information about the risks in relation to the lack of exchangeability; and
- information about the transactions or foreign operations affected.

Feedback summary and next steps

Responses on the exposure draft showed general support for the proposals, with some suggestions from respondents in respect of:

- assessing exchangeability between two currencies;
- determining the spot exchange rate when exchangeability is lacking;
- disclosure; and
- transition.

Our **comment letter** (PDF 200KB) sets out the KPMG position on these and other issues.

The Board is expected to analyse the feedback and decide on the project direction during Q2 2022. In the meantime, speak to your usual KPMG contact and visit **home.kpmg/ifrs** to keep up to date with the latest news and discussion on this topic.

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