STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	Lack of Exchangeability (Amendments to IAS 21)	
Paper topic	Determining the spot exchange rate when exchangeability is lacking—Possible way forward	
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Introduction and purpose

1. In April 2021 the International Accounting Standards Board (IASB) published the Exposure Draft *Lack of Exchangeability*, which proposed amendments to IAS 21 *The Effects of Changes in Foreign Exchange Rates.* The project originated from a submission to the IFRS Interpretations Committee (Committee)—the Committee's discussions identified the need to add requirements to IAS 21 on how an entity determines whether a currency is exchangeable into another currency and the accounting requirements to apply when it is not.

2. In January 2022 the IASB discussed a summary of the feedback (January 2022 Agenda Paper) on the Exposure Draft. IASB members did not make any decisions at that meeting; they provided initial thoughts for the staff to consider in further analysing the feedback.

3. In May 2022 we asked Emerging Economies Group (EEG) members to provide views (May 2022 Report of the EEG Meeting) on the staff's preliminary suggestions on possible ways forward on two proposals in the Exposure Draft—(1) assessing exchangeability between two currencies, and (2) determining the spot exchange rate when exchangeability is lacking.

4. We plan to bring a paper to a future IASB meeting analysing the feedback and providing recommendations on the project direction.

Structure of this paper

5. To help us in developing recommendations for the IASB, we are asking Committee members for their views on a possible way forward on one of the proposals in the Exposure Draft—determining the spot exchange rate when exchangeability is lacking. We have developed our analysis and recommendations in this paper considering the feedback on the Exposure Draft, IASB members' initial thoughts and EEG members' views.

6. We note that the possible way forward discussed in this paper outlines our *preliminary* views, which may change or be refined before we ask the IASB to make decisions.

7. This paper:

   (a) summarises the proposed amendments (paragraph 9);

   (b) describes the main matters raised by respondents and provides preliminary staff analysis and views (paragraphs 10–35); and

   (c) summarises the possible way forward (paragraph 36) and sets out questions for the Committee.

8. Appendix A to this paper provides a summary of feedback and update on other proposals in the Exposure Draft. Appendix B to this paper sets out examples to illustrate how an entity might apply the possible changes to the proposed requirements in estimating the spot exchange rate.

Summary of the proposed amendments

9. The Exposure Draft proposed that when exchangeability between two currencies is lacking (when a currency is not exchangeable into another currency at a measurement date), an entity would estimate the spot exchange rate at that date. The Exposure Draft proposed to add paragraphs 19A–19C and A12–A15 to IAS 21 to provide requirements applicable to an entity estimating the spot exchange rate; those proposals are discussed below.

Main matters raised by respondents and preliminary staff analysis and views

10. Most respondents to the Exposure Draft agreed with the proposal to require an entity to estimate the spot exchange rate when exchangeability between two currencies is lacking. Some respondents agreed fully with the proposed requirements on how to estimate the spot exchange rate; most asked for further clarification or suggested changes. Some respondents disagreed with or expressed concerns about an entity estimating the spot exchange rate when there is a lack of reliable market data.

Estimated rates meeting the conditions in paragraph 19A

Proposed requirements

11. Proposed paragraph 19A of the Exposure Draft states:

> When exchangeability between two currencies is lacking—that is, when a currency is not exchangeable into another currency (as described in paragraphs A2–A11) at a measurement date—an entity shall estimate the spot exchange rate at that date. The estimated spot exchange rate shall meet the following conditions assessed at the measurement date:
>
> (a) 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;
>
> (b) a rate that would have applied to an orderly transaction between market participants; and
>
> (c) a rate that faithfully reflects the prevailing economic conditions.

Respondents' comments

12. Respondents' comments on this aspect of the proposals include the following:

(a) a few respondents said, when exchangeability is lacking, meeting the conditions in proposed paragraph 19A may be impracticable;

(b) one respondent questioned whether exchangeability would actually be lacking if the conditions were met; and

(c) some respondents suggested revising the proposal to specify that the conditions are objectives an entity aims to meet when estimating the spot exchange rate, rather than requirements to be met.

Approach considered for EEG members' feedback

13. After considering respondents' feedback, we think paragraph 19A of the Exposure Draft (reproduced in paragraph 11 above) fails to convey with sufficient clarity how the IASB intended an entity to apply the proposed requirements. In applying paragraph 19A, an entity would need to estimate the spot exchange rate in such a way that the conditions would be met—even though the entity may be unable to enter into a market transaction to exchange one currency for another at the estimated rate on the measurement date. In other words, in a situation in which exchangeability is lacking, an entity applying paragraph 19A could be required to factor in conditions that do not necessarily exist in the market.

14. We acknowledge respondents' comments that it may be difficult to determine an estimated spot exchange rate that meets all conditions in proposed paragraph 19A. Therefore, for our discussion with EEG members at their May 2022 meeting, we suggested an approach that would require an entity to *best reflect*, rather than meet, all the conditions in paragraph 19A. This approach would require an entity to make its *best efforts* to meet the conditions in paragraph 19A but would not *require* the entity to meet all the conditions.

EEG members' views

15. At the May 2022 EEG meeting, we asked EEG members whether they agree with this possible way forward—to amend the proposal in paragraph 19A to require an entity to best reflect, rather than meet, all the conditions in that paragraph. EEG members generally agreed with the possible way forward. However, a few EEG members suggested changing 'conditions' to 'indicators' or 'factors' an entity considers. One EEG member said 'best reflect' would not necessarily clarify whether an entity is required to meet all the conditions.

Alternative for Committee members' feedback

16. Considering the feedback from EEG members, we think changing only 'meet' the conditions to 'best reflect' the conditions might not achieve what the IASB intended, in particular if we continue to refer to the three conditions set out in proposed paragraph 19A as 'conditions'. Using the word 'conditions' implies the three criteria or factors could be met or could exist at the measurement date in all circumstances, whereas the objective is to estimate a rate at which an exchange transaction *hypothetically* would take place at that date. This is similar to measuring an asset or liability at fair value when an entity estimates the price at which an orderly transaction to sell the asset or transfer the liability hypothetically would take place at the measurement date.

17. Accordingly, we propose—as an alternative—to amend paragraph 19A to state that an entity's objective in estimating the spot exchange rate is to reflect at the measurement date the rate at which an orderly exchange transaction would take place between market participants under prevailing economic conditions. We think this approach is consistent with the IASB's intent in developing the proposals while being responsive to feedback on the Exposure Draft. We also note that the structure, and some of the wording, of this proposed objective is similar to that of the objective set out in paragraph 2 of IFRS 13 *Fair Value Measurement* when measuring an asset or liability at fair value.

Observable exchange rates in paragraph 19B

Proposed requirements

18. Proposed paragraph 19B and paragraph BC19 of the Basis for Conclusions on the Exposure Draft state:

> 19B. In estimating the spot exchange rate as required by paragraph 19A, an entity may use an observable exchange rate as the estimated spot exchange rate when that observable exchange rate meets the conditions in paragraph 19A and is either:

> (a) a spot exchange rate for a purpose other than that for which the entity assesses exchangeability; or
>
> (b) the first exchange rate at which an entity is able to obtain the other currency after exchangeability of the currency is restored (first subsequent exchange rate).
>
> BC19. The Board noted that when a currency is not exchangeable into another currency, an entity would not necessarily need to use a complex estimation technique. In some situations an entity could estimate the spot exchange rate by starting with an observable exchange rate and adjusting that rate, as necessary, to estimate the spot exchange rate as proposed in paragraph 19A. To reduce complexity, the Board also decided to explicitly permit an entity to use an observable exchange rate as the estimated spot exchange rate in two situations if that observable exchange rate would meet the conditions in proposed paragraph 19A…

Respondents' comments

19. Respondents' comments on this aspect of the proposals include the following:

    (a) some respondents said the wording in proposed paragraph 19B is unclear.

    (b) some respondents commented on the proposal to permit, but not require, an entity to use an observable exchange rate as the estimated spot exchange rate. These respondents suggested:

        (i) requiring an entity to use observable exchange rates, including a rebuttable presumption to this effect or requiring the disclosure of reasons for not using an observable exchange rate.

        (ii) maximising the use of observable exchange rates, similar to the fair value hierarchy in IFRS 13.

        (iii) specifying a required sequencing of using observable exchange rates. Respondents had differing views on what the sequence should be.

Approach considered for EEG members' feedback

20. Requiring an entity to use, or maximise the use of, observable exchange rates or specifying a required sequencing of using observable exchange rates might increase comparability across entities affected by a lack of exchangeability. However, for our discussion with EEG members at their May 2022 meeting, we suggested that the IASB continue to permit, but not require, the use of observable exchange rates and further explain the reasons in the Basis for Conclusions. Those reasons include:

    (a) the proposed requirement in paragraph 19B to explicitly permit an entity to use either of the observable exchange rates specified in paragraph 19B (if paragraph 19A is also met) is intended to reduce complexity for entities in estimating the spot exchange rate—as explained in paragraph BC19 of the Basis for Conclusions on the Exposure Draft.

    (b) mandating a hierarchy of exchange rates may impose costs without providing more useful information for investors. Estimation of the spot exchange rate depends on the identified reporting purpose and is entity-specific. Mandating a hierarchy of exchange rates would require an entity to look for and successively consider each exchange rate in the hierarchy, when it may be more cost effective for the entity to use another estimation technique that would result in a rate that complies with paragraph 19A.

EEG members' views

21. At the May 2022 EEG meeting, we asked EEG members whether they agree with the possible way forward—to continue to permit, but not require, the use of observable exchange rates and further explain the reasons in the Basis for Conclusions. One EEG member agreed with the possible way forward and suggested incorporating some of the content in paragraph BC19 of the Basis for Conclusions on the Exposure Draft into the requirements. One EEG member said it is important to be consistent with the approach in IFRS 13. Another EEG member suggested the amendments prioritise observable exchange rates.

Approach for Committee members' feedback

22. On balance, we propose to maintain our approach of permitting, but not requiring, the use of observable exchange rates and further explaining the reasons in the Basis for Conclusions—as discussed in paragraph 20 of this paper. We also think our suggested change to paragraph 19A (to state an entity's objective in estimating the spot exchange rate as set forth in paragraph 17 of this paper) simplifies the structure of that paragraph and helps to clarify how paragraph 19B interacts with paragraph 19A.

Use of unofficial rates

Proposed amendments

23. Proposed paragraphs A2–A11 of the Exposure Draft specify requirements for assessing whether exchangeability between two currencies is lacking. Proposed paragraph A7 states 'in assessing whether a currency is exchangeable into another currency, an entity shall consider only markets or exchange mechanisms in which a transaction to exchange the currency for the other currency would create enforceable rights and obligations…'.

24. Proposed paragraphs 19A–19B are silent on the use of unofficial (or 'parallel market' or 'black market') rates in determining the spot exchange rate when exchangeability is lacking.

Respondents' comments

25. Some respondents suggested clarifying that an entity cannot consider unofficial rates in assessing exchangeability between two currencies but, when exchangeability is lacking, those rates can be used to estimate the spot exchange rate. Some respondents provided information—based on their experience—about parallel market rates in particular jurisdictions.

Approach considered for EEG members' feedback

26. Although proposed paragraphs 19A–19B are silent on the use of unofficial rates, it is not the IASB's intent to prevent the use of those rates in estimating the spot exchange rate when exchangeability is lacking—the Exposure Draft does not have any requirements preventing the use of those rates in estimating the spot exchange rate.

With that said, we acknowledge respondents' feedback that it might be unclear whether those rates can be used in estimating the spot exchange rate. Depending on the facts and circumstances, in our view unofficial rates can provide useful information, including about the prevailing economic conditions, for purposes of estimating the spot exchange rate. Therefore, for our discussion with EEG members at their May 2022 meeting, we suggested an approach that would clarify that those rates cannot be used in assessing exchangeability between two currencies but can be used as a starting point for estimating the spot exchange rate when exchangeability is lacking.

EEG members' views

27. At the May 2022 EEG meeting, we asked EEG members whether they agree with this possible way forward—to clarify that unofficial rates cannot be used in assessing exchangeability between two currencies but can be used as a starting point for estimating the spot exchange rate when exchangeability is lacking. EEG members generally agreed with the suggestion. Some EEG members commented on the challenges in referring to unofficial rates in IFRS Accounting Standards.

Approach for Committee members' feedback

28. We continue to support the approach we discussed with EEG members. We agree with EEG members' feedback about the challenges in referring to unofficial rates in IFRS Accounting Standards—unofficial rates are neither defined in IFRS Accounting Standards nor might they have the same meaning in different jurisdictions. Therefore, we propose to refer to 'rates from exchange transactions that do not create enforceable rights and obligations' rather than 'unofficial rates'. We also propose to clarify that those rates cannot be used in assessing exchangeability between two currencies but can be used as a starting point for estimating the spot exchange rate when exchangeability is lacking.

Reference rates, examples and application guidance

Proposed requirements

29. Paragraph BC18 of the Basis for Conclusions on the Exposure Draft states:

> …The Board did not propose any detailed requirements on how an entity should [estimate the spot exchange rate] because:
>
> (a) estimating a spot exchange rate can be complicated and would depend on entity-specific and jurisdiction-specific facts and circumstances.
>
> (b) there are many economic models an entity might use to estimate a spot exchange rate… Prescribing one estimation technique or approach would be inappropriate because it would be unlikely to capture all relevant factors for all possible situations in a way that would not be too burdensome.
>
> (c) the requirements for assessing exchangeability are expected to result in an entity estimating the spot exchange rate only in a narrow set of circumstances.
>
> (d) the uncertainties inherent in estimating a spot exchange rate are similar to those that relate to other financial information based on estimates. Disclosing relevant information about the estimated spot exchange rate and the estimation technique would supplement the proposed approach…
>
> (e) such an approach is consistent with the measurement requirements in other IFRS Standards…

Respondents' comments

30. Some respondents suggested permitting the use of particular inputs, mechanisms or reference rates in estimating the spot exchange rate—for example, purchase parity indices, implied rates and methods based on bonds traded on foreign markets.

31. Some respondents requested examples and application guidance on aspects of the proposals, including to support application of paragraphs 19A and 19B and on techniques and inputs to use in estimating the spot exchange rate.

Approach considered for EEG members' feedback

32. For our discussion with EEG members at their May 2022 meeting, we suggested maintaining the approach in the Exposure Draft of not identifying particular reference rates to be used in estimating the spot exchange rate and not providing examples and

application guidance on estimation techniques and approaches. We reaffirmed the reasons as stated in paragraph BC18 of the Basis for Conclusions on the Exposure Draft (reproduced in paragraph 29 of this paper). As explained in that paragraph, estimating the spot exchange rate can be complicated and would depend on entity-specific and jurisdiction-specific facts and circumstances. Therefore, any detailed requirements, application guidance or examples would be unlikely to capture all relevant factors for all possible situations, and therefore would risk being misleading. We also think other proposed changes to the requirements (as outlined above) would provide clarification and reduce the need for additional examples and application guidance.

EEG members' views

33. At the May 2022 EEG meeting, we asked EEG members whether they agree with the possible way forward—not to add examples or application guidance on estimation methodologies for the reasons explained in the Basis for Conclusions. EEG members had mixed views on the possible way forward. Some EEG members encouraged the IASB to add examples or application guidance. One EEG member expressed a preference for examples but understood the IASB's reasons for not providing them.

Approach for Committee members' feedback

34. We continue to support the approach and reasoning in the Exposure Draft of not providing detailed estimation requirements or describing particular estimation techniques. We think the combined package of possible changes (as summarised in paragraph 36 of this paper) would clarify the requirements for estimating the spot exchange rate and reduce the need for additional examples and application guidance. However, in the light of our suggested changes to the proposed requirements and as discussed below, we suggest revising Illustrative Example 4 in the Exposure Draft and adding examples to illustrate how an entity might apply the requirements in estimating the spot exchange rate.

Changes to Illustrative Examples

35. As outlined in Appendix B to this paper, we suggest revising Illustrative Example 4 in the Exposure Draft and adding examples; these examples would illustrate how an entity might apply:

    (a) the requirements in paragraph 19A—the entity's objective in estimating the spot exchange rate;

    (b) the requirements in paragraph 19B—there is no hierarchy of exchange rates to use. Depending on the specific facts and circumstances, an entity considers whether to use an observable exchange rate (as permitted by paragraph 19B) or another estimation technique to meet the objective in paragraph 19A; and

    (c) the use of rates from exchange transactions that do not create enforceable rights and obligations—the entity cannot use exchange transactions that do not create enforceable rights and obligations in assessing exchangeability between two currencies but can use rates from such transactions as a starting point for estimating the spot exchange rate.

Summary of the possible way forward

36. In summary, after considering the feedback, our preliminary views on a possible way forward on one of the proposals in the Exposure Draft—determining the spot exchange rate when exchangeability is lacking—are as follows:

    (a) the conditions in paragraph 19A—we propose amending paragraph 19A so that it no longer requires an entity to meet the conditions listed in that paragraph. Instead, paragraph 19A would state that an entity's objective in estimating the spot exchange rate is to reflect at the measurement date the rate at which an orderly exchange transaction would take place between market participants under prevailing economic conditions;

    (b) observable exchange rates in paragraph 19B—we propose to continue to permit, but not require, the use of observable exchange rates and further explain the reasons in the Basis for Conclusions;

(c) use of unofficial rates—we propose clarifying that rates from exchange transactions that do not create enforceable rights and obligations can be used as a starting point for estimating the spot exchange rate when exchangeability is lacking; and

(d) reference rates, examples and application guidance—we propose to maintain the approach of not providing or describing detailed estimation requirements or particular estimation techniques. We suggest revising Illustrative Example 4 in the Exposure Draft and adding examples to illustrate how an entity might apply the requirements in estimating the spot exchange rate when exchangeability is lacking.

Questions for the Committee
1. Do Committee members agree with our preliminary views as summarised in paragraph 36 of this paper? If 'yes', why? If 'no', do you have any other suggestions? 2. Do Committee members have any comments on our suggested illustrative examples outlined in Appendix B to this paper? We are asking for comments on the substance of the proposed illustrative examples, rather than detailed drafting suggestions. The drafting of any new illustrative examples accompanying IAS 21 would be subject to extensive review.

Appendix A—Summary of feedback and update on other proposals in the Exposure Draft

A1. This appendix sets out a summary of feedback and update on other proposals in the Exposure Draft.

Assessing exchangeability between two currencies

General comments

Proposed amendments

A2. The Exposure Draft proposed to amend IAS 21 to set out factors an entity considers in assessing exchangeability and specify how those factors affect the assessment. Paragraphs BC4–BC16 of the Basis for Conclusions on the Exposure Draft explain the IASB's rationale for this proposal. In particular:

(e) Paragraph 8 of the Exposure Draft adds a definition of 'exchangeable', which states:

> A currency is *exchangeable* into another currency when an entity is able to exchange that currency for the other currency.

(f) paragraph BC4 of the Basis for Conclusions on the Exposure Draft states:

> Many factors influence exchangeability between two currencies. To make the definition proposed in paragraph 8 operational and to help entities apply that definition consistently, the Board is proposing to specify when an entity is able (and thus unable) to exchange a currency for another currency. In identifying the factors required to be considered in making the assessment, the Board considered:
>
> (a) what time frame for obtaining the other currency does an entity consider (paragraph BC5)?
>
> (b) what if an entity is able to obtain the other currency, but does not intend to do so (paragraph BC6)?
>
> (c) which markets or exchange mechanisms for obtaining the other currency does an entity consider (paragraph BC7)?

(d) what is the purpose for which an entity obtains the other currency (paragraphs BC8–BC12)?

(e) what if an entity is able to obtain only limited amounts of the other currency (paragraphs BC13–BC16)?

Respondents' comments

A3. Many respondents agreed with the proposed definition of 'exchangeable' and the factors an entity is required to consider in assessing whether a currency is exchangeable. One respondent disagreed with the proposal, suggesting a lack of exchangeability be determined by 'the accounting association of a country as a whole'; otherwise different entities may reach different conclusions, affecting comparability.

A4. Many respondents commented on the factors an entity considers in assessing exchangeability. Some respondents commented on the level at which exchangeability is assessed and the proposed definition of 'exchangeable'. Some respondents also commented on other matters.

Holistic consideration of factors in assessing exchangeability

Proposed amendments

A5. The Exposure Draft requires an entity to consider holistically all factors in proposed paragraphs A2–A11 in assessing exchangeability.

Respondents' comments

A6. Feedback indicates that some respondents read the proposals to say that, in assessing exchangeability, each of the factors would be considered individually or separately, instead of holistically. If considered individually or separately, questions then arise about the interaction between the factors.

EEG members' views

A7. At the May 2022 EEG meeting, EEG members agreed with the staff's suggested way forward—an entity needs to consider holistically all the proposed factors in assessing exchangeability. A few EEG members provided additional comments as summarised on page 3 of the May 2022 Report of the EEG Meeting.

Level of assessment of exchangeability

Proposed amendments

A8. The Exposure Draft does not propose to change IAS 21's level of assessment and application (which is at an entity level)[1].

Respondents' comments

A9. A few respondents suggested exchangeability be assessed at a jurisdiction level, rather than at an entity level—similar to assessing hyperinflation in IAS 29[2].

EEG members' views

A10. At the May 2022 EEG meeting, EEG members generally agreed with the staff's suggested way forward—the assessment of exchangeability should be at an entity level. A few EEG members said it might be beneficial to state that entities in a jurisdiction experiencing similar exchangeability circumstances would be expected to reach the same conclusions.

Disclosure

Proposed amendments

A11. Estimating the spot exchange rate when exchangeability between two currencies is lacking could materially affect an entity's financial statements. That estimation would also require the use of judgements and assumptions. In developing the Exposure Draft, the IASB was informed that users of financial statements (investors) are interested not only in the effect on the financial statements of estimating the spot exchange rate, but in understanding an entity's exposure to a currency that lacks exchangeability. Investors said information about the nature and financial effects of a lack of exchangeability, the spot exchange rate used, the estimation process and the risks to which the entity is exposed would help their analyses. The proposed disclosure requirements were therefore designed to provide investors with such information.

[1] Paragraph 3 of IAS 21 states 'this Standard shall be applied: (a) in accounting for transactions and balances in foreign currencies…; (b) in translating the results and financial position of foreign operations that are included in the financial statements of the entity by consolidation or the equity method; and (c) in translating an entity's results and financial position into a presentation currency'.

[2] Paragraph 4 of IAS 29 states 'it is preferable that all entities that report in the currency of the same hyperinflationary economy apply this Standard from the same date…'.

A12. The Exposure Draft proposed to amend IAS 21 to require an entity to disclose information that would enable investors to understand how a lack of exchangeability between two currencies affects, or is expected to affect, its financial performance, financial position and cash flows. Paragraphs BC21–BC23 of the Basis for Conclusions on the Exposure Draft explain the IASB's rationale for this proposal.

Respondents' comments

A13. Many respondents agreed with the proposed disclosure requirements for the reasons the IASB explained while some respondents expressed concerns about those proposed requirements. One respondent disagreed with the proposal and said the disclosure objective in proposed paragraph 57A is too broad and may not be operational or enforceable; this respondent suggested replacing the disclosure objective with a 'narrower specific' disclosure objective.

EEG members' views

A14. We did not ask EEG members to provide views on this proposal.

Transition

Proposed amendments

A15. The Exposure Draft proposed to amend IAS 21 to require an entity to apply the amendments from the date of initial application and permit earlier application. The IASB proposed no exemption from retrospective application for first-time adopters. Paragraphs BC24–BC27 of the Basis for Conclusions on the Exposure Draft explain the IASB's rationale for the proposed transition requirements.

Respondents' comments

A16. Most respondents agreed with the proposed transition requirements for the reasons the IASB explained.

EEG members' views

A17. We did not ask EEG members to provide views on this proposal.

Appendix B—Examples to illustrate how an entity might apply the possible changes to the proposed requirements in estimating the spot exchange rate

B1. We have revised Illustrative Example 4 in the Exposure Draft and added examples to illustrate how an entity might apply the possible changes to the proposed requirements in estimating the spot exchange rate.

B2. The examples are not intended to provide interpretative guidance; rather, they illustrate how an entity might apply some of the requirements in hypothetical situations based on the limited facts presented. Although some aspects of the examples may be present in actual fact patterns, fact patterns in those examples are simplified, and an entity would need to evaluate all relevant facts and circumstances when applying the requirements.

B3. In each of the following fact patterns, Entity X has a functional and presentation currency of PC and prepares consolidated financial statements. Entity X has a subsidiary, Entity Y, that is a foreign operation. Entity Y's functional currency is LC, the currency of the jurisdiction in which Entity Y operates. The relevant jurisdictional authority administers the exchangeability of LC for other currencies. Entity X is required to determine the spot exchange rate between LC and PC for the purpose of translating Entity Y's results and financial position for inclusion in its consolidated financial statements.

Step II: Determining the spot exchange rate when exchangeability is lacking (paragraphs 19A–19B and A12–A15)

IE9 When exchangeability between two currencies is lacking, an entity estimates the spot exchange rate at that date. The entity's objective in estimating the spot exchange rate is to reflect at the measurement date the rate at which an orderly exchange transaction would take place between market participants under prevailing economic conditions. In estimating the spot exchange rate, depending on the specific facts and circumstances, an entity considers whether to use an observable exchange rate (as permitted by paragraph 19B) or another estimation technique. An entity considers other estimation techniques that are appropriate in the circumstances and for which sufficient data is available to estimate the spot exchange rate.

Example 4—Using an observable exchange rate for another purpose (paragraph 19B(a))

Fact pattern

IE10 At 31 December 20X1, the jurisdictional authority in Entity Y's jurisdiction prevents entities from obtaining PC for a purpose that would result in the realisation of a net investment in an entity operating in that jurisdiction. Other than that restriction, entities are able to obtain PC and the LC:PC exchange rate is free-floating. Only one exchange rate applies to transactions for exchanges of LC for PC; it is updated several times a day.

Assessing exchangeability between LC and PC

IE11 At the measurement date of 31 December 20X1, because Entity X is unable to obtain PC to realise its net investment in Entity Y, Entity X concludes that LC is not exchangeable into PC.

Estimating the spot exchange rate

IE12 Because Entity X concludes that LC is not exchangeable into PC, Entity X is required to estimate the spot exchange rate that reflects at the measurement date the rate at which an orderly exchange transaction would take place between market participants under prevailing economic conditions (paragraph 19A).

IE13 Entity X considers whether it might use the observable LC:PC exchange rate that is used for purposes other than the realisation of a net investment in an entity. To do so, it assesses whether that observable exchange rate meets the objective in paragraph 19A for the purpose of realising its net investment in Entity Y. In doing so, Entity X applies paragraph A13 and considers:

(a) *whether several exchange rates exist*—only one observable exchange rate exists between LC and PC.

(b) *the purpose for which the currency is exchangeable*—Entity X is able to obtain PC for any transaction other than a transaction that would result in the realisation of its net investment in Entity Y.

(c) *the nature of the exchange rate*—the observable exchange rate is free-floating.

(d) *the frequency with which exchange rates are updated*—the observable exchange rate is updated several times a day.

IE14 Considering these factors, Entity X determines that, in estimating the spot exchange rate for the purpose of realising its net investment in Entity Y, the observable LC:PC exchange rate meets the objective in paragraph 19A. Therefore, Entity X may use that observable exchange rate as the estimated spot exchange rate when it translates the results and financial position of Entity Y.

Example 5—Using the first subsequent exchange rate (paragraph 19B(b))

Fact pattern

IE15 At 31 December 20X1, the jurisdiction in which Entity Y operates is subject to hyperinflation and the jurisdictional authority in Entity Y's jurisdiction prevents entities from obtaining PC for a purpose that would result in the realisation of a net investment in an entity operating in that jurisdiction. Four months later, at 30 April 20X2, that jurisdictional authority then allows entities to obtain PC for a purpose that would result in the realisation of a net investment in an entity operating in that jurisdiction.

Assessing exchangeability between LC and PC

IE16 At the measurement date of 31 December 20X1, because Entity X is unable to obtain PC to realise its net investment in Entity Y, Entity X concludes that LC is not exchangeable into PC.

Estimating the spot exchange rate

IE17 Because Entity X concludes that LC is not exchangeable into PC, Entity X is required to estimate the spot exchange rate that reflects at the measurement date the rate at which an orderly exchange transaction would take place between market participants under prevailing economic conditions (paragraph 19A).

IE18 Entity X considers whether it might use the first exchange rate at which an entity is able to obtain the other currency after exchangeability of the currency is restored (first subsequent exchange rate). To do so, it assesses whether that first subsequent exchange rate meets the objective in paragraph 19A for the purpose of realising its net investment in Entity Y. In doing so, Entity X applies paragraph A15 and considers:

(a) *the time between the measurement date and the date at which exchangeability is restored*—the measurement date is 31 December 20X1 and exchangeability is restored four months later at 30 April 20X2.

(b) *inflation rate*—the jurisdiction in which Entity Y operates is subject to hyperinflation.

IE19 Considering these factors, Entity X determines that the first subsequent exchange rate does not reflect the prevailing economic conditions at the measurement date and, therefore, does not meet the objective in paragraph 19A for the purpose of realising Entity X’s net investment in Entity Y.

Other estimation technique

IE20 In estimating the spot exchange rate, Entity X considers whether it might use the first subsequent exchange rate described in paragraphs IE18–IE19 as a starting point (which it would then adjust) by taking into account the following information:

(a) exchangeability is restored four months after the measurement date—Entity X considers that the time period that elapses before exchangeability is restored is not short.

(b) the jurisdiction in which Entity Y operates is subject to hyperinflation—Entity X considers that the first subsequent exchange rate does not reflect the prevailing economic conditions at the measurement date and assesses that changes in inflation rates are the main determinant of exchange rate movements. Information about inflation rates in the jurisdictions in which Entity X and Entity Y operate is publicly available.

IE21 Considering these factors, Entity X adjusts the first subsequent exchange rate accordingly and determines that the adjusted rate meets the objective in paragraph 19A for the purpose of realising Entity X's net investment in Entity Y. Therefore, Entity X may use that adjusted rate as the estimated spot exchange rate when it translates the results and financial position of Entity Y.

Example 6—Using rates from exchange transactions that do not create enforceable rights and obligations

Fact pattern

IE22 At 31 December 20X1, the jurisdictional authority in Entity Y's jurisdiction prevents entities from obtaining PC for a purpose that would result in the realisation of a net investment in an entity operating in that jurisdiction. However, individual resellers settle transactions to exchange LC for PC at an exchange rate not set by the jurisdictional authority and such exchange transactions do not create enforceable rights and obligations.

Assessing exchangeability between LC and PC

IE23 In assessing whether LC is exchangeable into PC, Entity X considers only markets or exchange mechanisms in which a transaction to exchange LC for PC would create enforceable rights and obligations. At the measurement date of 31 December 20X1, because Entity X is unable to obtain PC to realise its net investment in Entity Y, Entity X concludes that LC is not exchangeable into PC.

Estimating the spot exchange rate

IE24 Because Entity X concludes that LC is not exchangeable into PC, Entity X is required to estimate the spot exchange rate that reflects at the measurement date the rate at which an orderly exchange transaction would take place between market participants under prevailing economic conditions (paragraph 19A).

Other estimation technique

IE25 Entity X considers whether it might use an estimation technique using rates from exchange transactions that do not create enforceable rights and obligations to determine the spot exchange rate. While such transactions are not considered in assessing whether LC is exchangeable into PC, Entity X can consider whether to use the exchange rate from such transactions as a starting point to estimate the spot exchange rate.

IE26 Entity X determines that, for the purpose of realising its net investment in Entity Y, it can use the exchange rate from such transactions as a starting point and adjust it as needed to meet the objective in paragraph 19A. Therefore, Entity X may use that rate as the estimated spot exchange rate when it translates the results and financial position of Entity Y.