STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Consolidation of a Non-Hyperinflationary Subsidiary by a Hyperinflationary Parent (IAS 21 and IAS 29)**
Paper topic	Initial consideration

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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the application of IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*. The submission asks about the accounting applied by a parent, whose functional currency is the currency of a hyperinflationary economy, when it consolidates a subsidiary whose functional currency is the currency of a non-hyperinflationary economy.

2. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation to conduct further research and outreach before asking the Committee to decide whether to add a standard-setting project to the work plan.

Structure of the paper

3. This paper includes the following:

   (a) background information (paragraphs 4–16);

(b) summary of outreach (paragraphs 17–22);

(c) staff analysis of the question in the submission (paragraphs 23–40); and

(d) staff analysis of whether to add a standard-setting project to the work plan (paragraphs 41–45).

Background information

The fact pattern

4. In the fact pattern described in the submission, a parent:

(a) has a functional currency[1] and presentation currency that is the currency of a hyperinflationary economy[2];

(b) has a subsidiary with a functional currency that is the currency of a non-hyperinflationary economy (non-hyperinflationary subsidiary); and

(c) in preparing its consolidated financial statements[3], applies paragraphs 39–41 of IAS 21[4] to translate the results and financial position of the non-hyperinflationary subsidiary into its presentation currency.

The question

5. The submission asks whether, in preparing its consolidated financial statements, the parent applies IAS 29 to restate the current year and comparative amounts presented for its non-hyperinflationary subsidiary. If the parent were to restate the current year and comparative amounts, it would express those amounts in terms of the measuring unit current at the end of the reporting period (the reporting date).

[1] Paragraph 8 of IAS 21 defines functional currency as 'the currency of the primary economic environment in which the entity operates'.

[2] Paragraph 3 of IAS 29 specifies characteristics that indicate an economy is hyperinflationary.

[3] Appendix A to IFRS 10 *Consolidated Financial Statements* defines consolidated financial statements as 'the financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity'.

[4] Paragraphs 39–41 of IAS 21 specify how to translate the results and financial position of a non-hyperinflationary entity into a different presentation currency. Paragraph 23 of this paper reproduces paragraph 39 of IAS 21.

6. The submission outlines both:

   (a) View I—the parent does not restate the results and financial position of its non-hyperinflationary subsidiary in terms of the measuring unit current at the reporting date; and

   (b) View II—the parent restates the results and financial position of its non-hyperinflationary subsidiary in terms of the measuring unit current at the reporting date.

7. Appendix A to this paper reproduces the submission, which provides further details about each view.

8. The simplified example in paragraphs 9–16 illustrates the fact pattern.

Simplified example

9. Assume Entity P (a parent) has a reporting date of 31 December, and a functional and presentation currency (HC) that is the currency of a hyperinflationary economy. Entity P owns 100% of the equity of Entity S (a subsidiary).

10. Entity S:

    (a) has a functional currency (NHC) that is the currency of a non-hyperinflationary economy;

    (b) was set up on 1 January 20X0 through an investment of HC1,000 by Entity P—the exchange rate on that date was NHC1: HC1, which resulted in an investment of NHC1,000 in Entity S;

    (c) used the proceeds of this investment to buy a non-depreciable non-monetary asset for NHC1,000 on 1 January 20X0;

    (d) generated revenue and cost of sales of NHC100 and NHC80 respectively in 20X0 and 20X1; and

    (e) has cash of NHC20 and NHC40 at 31 December 20X0 and 20X1 respectively.

11. The exchange rates between the two currencies are:

    (a) 1 January 20X0: NHC1: HC1

    (b) 31 December 20X0: NHC1: HC4

(c) 31 December 20X1: NHC1: HC15

(d) average rate during 20X0: NHC1: HC2.5

(e) average rate during 20X1: NHC1: HC10

12. The Consumer Price Index of the hyperinflationary economy in which Entity P operates is:

(a) 31 December 20X0: 100

(b) 31 December 20X1: 300

(c) average price index during 20X0: 75

(d) average price index during 20X1: 225

13. Entity S's results and financial position at 31 December 20X0 and 20X1 (before applying paragraph 39 of IAS 21) are:

	20X0 (NHC)	20X1 (NHC)
Results		
Revenue	100	100
Cost of sales	(80)	(80)
Financial position		
Cash	20	40
Non-depreciable non-monetary asset	1,000	1,000

Applying paragraph 39 of IAS 21

14. Applying paragraph 39 of IAS 21, Entity P translates Entity S's results and financial position at the average rate[5] and closing rate respectively. The tables[6] below show Entity S's results and financial position at 31 December 20X0 and 20X1:

	20X0 (NHC)	20X0 exchange rate	20X0 (HC)
	A	B	C = A x B
Results			
Revenue	100	2.5	250
Cost of sales	(80)	2.5	(200)

[5] Entity P translates income and expenses at exchange rates at the dates of the transactions. For practical reasons, the average rate for the period is used (paragraph 40 of IAS 21).

[6] The example does not illustrate the resulting exchange differences from translation that Entity P recognises in other comprehensive income (paragraph 39(c) of IAS 21).

Financial position			
Cash	20	4	80
Non-depreciable non-monetary asset	1,000	4	4,000

	20X1 (NHC)	20X1 exchange rate	20X1 (HC)
	A	B	C = A x B
Results			
Revenue	100	10	1,000
Cost of sales	(80)	10	(800)
Financial position			
Cash	40	15	600
Non-depreciable non-monetary asset	1,000	15	15,000

	20X0 (HC)	20X1 (HC)
Results		
Revenue	250	1,000
Cost of sales	(200)	(800)
Financial position		
Cash	80	600
Non-depreciable non-monetary asset	4,000	15,000

View I

15. If Entity P were to apply View I, Entity S's results and financial position at 31 December 20X0 and 20X1—included in Entity P's consolidated financial statements—are as illustrated above.

View II

16. If Entity P were to apply View II, Entity S's results and financial position (current year and comparative amounts) included in Entity P's consolidated financial statements at 31 December 20X1 are:

Entity S's results and financial position at 31 December 20X1 expressed in terms of the measuring unit current at 31 December 20X1

	20X1 (HC)	Change in price index	Restated (HC)
	C	D	E = C x D
Results			
Revenue	1,000	1.3[7]	1,333
Cost of sales	(800)	1.3	(1,067)
Financial position			
Cash	600	1[8]	600
Non-depreciable non-monetary asset	15,000	1	15,000

Entity S's results and financial position at 31 December 20X0 (comparatives) expressed in terms of the measuring unit current at 31 December 20X1

	20X0 (HC)	Change in price index	Restated (HC)
	C	D	E = C x D
Results			
Revenue	250	4[9]	1,000
Cost of sales	(200)	4	(800)
Financial position			
Cash	80	3[10]	240
Non-depreciable non-monetary asset	4,000	3	12,000

[7] Because income and expenses are translated using the average rate during 20X1, restatement to the measuring unit current at 31 December 20X1 requires applying the change in price index from the average price index during 20X1 to the price index at 31 December 20X1, ie 300 ÷ 225 ≈ 1.3.

[8] There is no further adjustment because Entity S's assets are translated into HC using the exchange rate at 31 December 20X1, which means the amounts are already stated in terms of the measuring unit current at that date.

[9] Because income and expenses are translated using the average rate during 20X0, restatement to the measuring unit current at 31 December 20X1 requires applying the change in price index from the average price index during 20X0 to the price index at 31 December 20X1, ie 300 ÷ 75 = 4.

[10] Restatement to the measuring unit current at 31 December 20X1 requires applying the change in price index from 31 December 20X0 to 31 December 20X1, ie 300 ÷ 100 = 3.

Entity S's results and financial position at 31 December 20X1 (stated in terms of the measuring unit current at that date)

	20X0 comparatives (HC)	20X1 (HC)
Results		
Revenue	1,000	1,333
Cost of sales	(800)	(1,067)
Financial position		
Cash	240	600
Non-depreciable non-monetary asset	12,000	15,000[11]

Summary of outreach

17. We sent information requests to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms. The submission was also made available on our website.

18. The request asked those participating to provide information about whether the submitted fact pattern is (was) common and, if so:

    (a) in which jurisdictions; and

    (b) whether there is diversity in accounting for the submitted fact pattern. If yes, is this evident only in particular jurisdictions?

19. We received 12 responses—seven from large accounting firms, three from national standard-setters and two from securities regulators. The views received represent informal opinions and do not reflect the official views of those respondents or their organisations.

Is the submitted fact pattern common?

20. Many respondents said the submitted fact pattern is common in particular jurisdictions (for example, Argentina, Lebanon, Turkey and Zimbabwe). Some of those respondents said the matter does not always have a material effect for entities affected

[11] The difference in the carrying amount (in HC) of the non-depreciable non-monetary asset arises because the change in closing rate from 31 December 20X0 to 31 December 20X1 does not move in tandem with the change in price index (the change in exchange rate is greater than the change in price index). If the change in closing rate were to move in tandem with the change in price index, ie closing rate at 31 December 20X1 is NHC1 : HC12, the carrying amount of the non-depreciable non-monetary asset would be HC12,000 (NHC1,000 x 12).

because non-hyperinflationary subsidiaries might represent only a small proportion of the operations of a group with a parent whose functional currency is the currency of a hyperinflationary economy.

21. Many other respondents said the submitted fact pattern is uncommon or they were unaware of the submitted fact pattern. Most of these respondents said the fact pattern could be common in jurisdictions experiencing hyperinflation.

Is there diversity in accounting for the submitted fact pattern?

22. Most respondents who said the submitted fact pattern is common in particular jurisdictions have observed diversity in accounting for it—they had observed some entities applying View I and other entities applying View II. One respondent said they had observed no diversity in accounting for the submitted fact pattern—they observed a few entities in Lebanon applying View I.

Analysis of the question in the submission

The applicable requirements in IAS 21 and IAS 29

What IAS 21 says

23. Paragraphs 44–47 specify requirements that apply when, for the purposes of consolidation, an entity translates the results and financial position of a subsidiary that is a foreign operation. Paragraph 44 states that paragraphs 38–43 also apply to that translation, and paragraphs 39–41 specify how to translate the results and financial position of a non-hyperinflationary subsidiary. Paragraph 39 states:

> 39. The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:
>
> (a) assets and liabilities for each statement of financial position presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position;

(b) income and expenses for each statement presenting profit or loss and other comprehensive income (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and

(c) all resulting exchange differences shall be recognised in other comprehensive income.

What IAS 29 says

24. Paragraph 1 states:

> This Standard shall be applied to the financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.

25. Paragraphs 2 and 7 explain why, in a hyperinflationary economy, financial statements without restatement are not useful. These paragraphs state:

> 2. In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.
>
> …
>
> 7. In a hyperinflationary economy, financial statements…are useful only if they are expressed in terms of the measuring unit current at the end of the reporting period. As a result, this Standard applies to the financial statements of entities reporting in the currency of a hyperinflationary economy…

26. Paragraphs 8 and 34 require an entity whose functional currency is that of a hyperinflationary economy to restate both current year and comparative amounts by expressing those amounts in terms of the measuring unit current at the end of the reporting period. These paragraphs state:

> 8. The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy…shall be stated in

> terms of the measuring unit current at the end of the reporting period. The corresponding figures for the previous period required by IAS 1 *Presentation of Financial Statements* (as revised in 2007) and any information in respect of earlier periods shall also be stated in terms of the measuring unit current at the end of the reporting period…
>
> 34. Corresponding figures for the previous reporting period…are restated by applying a general price index so that the comparative financial statements are presented in terms of the measuring unit current at the end of the reporting period. Information that is disclosed in respect of earlier periods is also expressed in terms of the measuring unit current at the end of the reporting period…

27. Paragraphs 35 and 36 apply to consolidated financial statements:

> 35. A parent that reports in the currency of a hyperinflationary economy may have subsidiaries that also report in the currencies of hyperinflationary economies. The financial statements of any such subsidiary need to be restated by applying a general price index of the country in whose currency it reports before they are included in the consolidated financial statements issued by its parent. Where such a subsidiary is a foreign subsidiary, its restated financial statements are translated at closing rates. The financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21.
>
> 36. If financial statements with different ends of the reporting periods are consolidated, all items, whether non-monetary or monetary, need to be restated into the measuring unit current at the date of the consolidated financial statements.

Applying the applicable requirements

28. In the submitted fact pattern, Entity P (whose functional currency is the currency of a hyperinflationary economy) applies IAS 29 in preparing its consolidated financial

statements. Paragraph 1 of IAS 29—reproduced in paragraph 24 of this paper—requires it to do so.

29. Paragraphs 35–36 of IAS 29—reproduced in paragraph 27 above—include requirements that specifically apply when preparing consolidated financial statements. The last sentence of paragraph 35 states that 'the financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21'. Accordingly, Entity P applies IAS 21 in translating Entity S's results and financial position from NHC to HC for inclusion in its consolidated financial statements.

30. Paragraphs 44–47 (as well as paragraphs 39–41) of IAS 21 apply to that translation.

31. Entity P therefore:

    (a) translates Entity S's assets at the closing rate at the date of each statement of financial position presented;

    (b) translates Entity S's income and expenses at exchanges rates at the dates of the transactions; and

    (c) recognises all resulting exchange differences in other comprehensive income.

32. Paragraphs 13 and 14 of this paper illustrate Entity S's results and financial position before and after applying paragraph 39 of IAS 21.

33. There would appear to be no doubt that, in the submitted fact pattern, paragraphs 44–47 (as well as paragraphs 39–41) of IAS 21 apply. The question that has arisen is whether, after having applied those paragraphs, Entity P restates Entity S's results and financial position in terms of the measuring unit current at the reporting date, as is required by IAS 29 for financial statements of an entity whose functional currency is the currency of a hyperinflationary economy.

View I—Entity P does not restate Entity S's results and financial position

34. Applying View I, Entity P does not restate Entity S's results and financial position after applying IAS 21 to translate those amounts from NHC to HC.

35. Proponents of View I highlight the requirement in the last sentence of paragraph 35 of IAS 29, which states 'the financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21'.

In their view, this requirement is clear in explaining that Entity P applies IAS 21 in translating the financial statements of Entity S for inclusion in its consolidated financial statements, and only IAS 21. The objective and requirements in IAS 29 that require financial statements to be restated in terms of the measuring unit current at the reporting date apply only to entities within a group whose functional currency is that of a hyperinflationary economy.

View II—Entity P restates Entity S's results and financial position

36. Applying View II, Entity P restates Entity S's results and financial position in terms of the measuring unit current at the reporting date, after applying IAS 21 to translate those amounts from NHC to HC.

37. Proponents of View II highlight requirements in IAS 29 that explain the reason for restating the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy in terms of the measuring unit current at the reporting date. They:

(a) note that paragraph 1 includes within the scope of IAS 29 the *consolidated financial statements* of any entity whose functional currency is that of a hyperinflationary economy.

(b) refer to the overall objective and requirements in IAS 29 that require the financial statements (including current year and comparative amounts) to be stated in terms of the measuring unit current at the reporting date (paragraphs 2, 7, 8 and 34 of IAS 29, reproduced in paragraphs 25–26 of this paper).

(c) consider that, in applying View II, Entity P complies with the requirement in paragraph 35 to deal with the financial statements of Entity S in accordance with IAS 21. They read the requirements in paragraph 35 as not preventing Entity P from restating Entity S's financial statements after having applied paragraphs 39–41 of IAS 21.

(d) note the requirement in paragraph 36, which states 'if financial statements with different ends of the reporting periods are consolidated, all items, whether non-monetary or monetary, need to be restated into the measuring unit current at the date of the consolidated financial statements'. That requirement does not differentiate between hyperinflationary and non-hyperinflationary subsidiaries.

It would therefore appear to suggest that the financial statements of all subsidiaries (including non-hyperinflationary subsidiaries) need to be restated in terms of the measuring unit current at the date of the consolidated financial statements.

Staff conclusion

38. Having analysed the applicable requirements in IAS 21 and IAS 29, we conclude that in preparing its consolidated financial statements Entity P applies paragraphs 39–41 of IAS 21 to translate Entity S's results and financial position into HC. Entity P could then either:

    (a) not restate Entity S's results and financial position in terms of the measuring unit current at the reporting date (View I); or

    (b) restate Entity S's results and financial position in terms of the measuring unit current at the reporting date (View II).

39. In other words, we conclude that, in the submitted fact pattern, an entity could reasonably read the applicable requirements in IAS 21 and IAS 29 to require—or not require—restatement in terms of the measuring unit current at the reporting date. The rationale for each view is set out in paragraph 35 (View 1) and paragraph 37 (View II) above.

40. Entity P would also disclose material accounting policy information in accordance with IAS 1 *Presentation of Financial Statements*.

Question 1 for the Committee
1. Does the Committee agree with our analysis and conclusion set out in paragraphs 23–40 of this paper?

Analysis of whether to add a standard-setting project to the work plan

Staff analysis

41. The Committee decides that a standard-setting project should be added to the work plan when all the criteria in paragraph 5.16 of the IFRS Foundation's *Due Process Handbook*) are met.

42. Based on our analysis in paragraphs 23–40 of this paper, for the submitted fact pattern we conclude that an entity could reasonably read the applicable requirements in two ways. We therefore also conclude that, for the submitted fact pattern, the principles and requirements in IFRS Accounting Standards do not provide an adequate basis for an entity to determine the required accounting (subparagraph 5.16(b)).

43. To determine whether to recommend adding a standard-setting project to the work plan, we have also considered the other criteria in paragraph 5.16 of the *Due Process Handbook*:

    (a) the matter has widespread effect and has, or is expected to have, a material effect on those affected (subparagraph 5.16(a))

        (i) does it have widespread effect? As explained in paragraphs 20–22 of this paper, many respondents to the outreach request said the submitted fact pattern is common in particular jurisdictions, while others said it could be common in jurisdictions experiencing hyperinflation. Of those who said the submitted fact pattern is common, most respondents have observed diversity in the accounting for the submitted fact pattern. Considering recent events that are affecting the world economy, the submitted fact pattern could become more common in the future.

        (ii) does it have a material effect on those affected? Some respondents to the outreach request indicated that the matter might not have a material effect for all entities affected—this is because, in jurisdictions such as Lebanon, it may be relatively uncommon for a Lebanese parent (with a functional currency of Lebanese Pound) to have material non-hyperinflationary subsidiaries. However, we understand that larger economies such as those of Argentina and Turkey are now considered to be hyperinflationary; the fact pattern may therefore more commonly have a material effect on those affected than in the past. As illustrated in paragraphs 14–16 of this paper, not restating Entity S's results and financial position (View I) could result in differences in Entity P's consolidated financial statements compared to restating Entity S's results and financial position (View II). We note that when hyperinflation occurs, economic conditions may deteriorate rapidly and the diverse views on the application of IFRS Accounting Standards in this fact pattern could lead to material differences in the financial statements of entities affected.

(b) the matter can be resolved efficiently within the confines of the existing Standards and the *Conceptual Framework*, and is sufficiently narrow in scope (subparagraph 5.16(c)–(d))

(i) the matter is narrow in scope. The submission (Appendix A to this paper) provides a suggestion to resolve the matter.

44. Nonetheless, we note that:

(a) hyperinflation occurs relatively infrequently, and further research might indicate that the matter applies to relatively few entities in jurisdictions with a hyperinflationary economy.

(b) neither this matter nor other matters related to IAS 29 have been raised as a priority in the IASB's *Third Agenda Consultation*.[12]

(c) there could be other matters with respect to the application of IAS 29 that stakeholders might suggest the IASB considers if a standard-setting project is added on this matter. Some respondents to the outreach request mentioned a

[12] Agenda Paper 24C of the March 2022's IASB meeting analysed potential projects based on feedback received from respondents to the *Third Agenda Consultation* and the criteria for deciding whether to add a project to the IASB's work plan. In particular, the Request for Information included a potential project on inflation, which most respondents viewed as low priority because high inflation or hyperinflation is not a prevalent matter for most economies.

related matter regarding a non-hyperinflationary entity that presents its financial statements in the currency of a hyperinflationary economy.

(d) views may be divided on what is considered to be the 'best' accounting. There are arguments for and against both View I and View II.

Staff recommendation

45. Considering the above, we recommend that we conduct further research and outreach to obtain the following before asking the Committee to decide whether to add a standard-setting project to the work plan:

(a) further information on the prevalence of the matter and whether it has (or is expected to have) a material effect on entities affected;

(b) information about other related matters (if any) with respect to the application of IAS 29; and

(c) information about the feasibility of possible narrow-scope standard-setting and the usefulness of the information provided by those possibilities.

Questions 2–4 for the Committee
2. Does the Committee agree with our recommendation to conduct further research and outreach before asking the Committee to decide whether to add a standard-setting project to the work plan? 3. Do Committee members have comments or views on the points raised in paragraph 44 of this paper or the information listed in paragraph 45 of this paper? 4. Is there information not listed in paragraph 45 of this paper that Committee members would want us to obtain in order to make an informed decision about whether to add a standard-setting project to the work plan?

Appendix A—submission

A1. We have reproduced the submission below and in doing so deleted details that would identify the submitter of this request.

IAS 29 CONSOLIDATION (IAS 29 Financial Reporting in Hyperinflationary Economies and IAS 21 The Effects of Changes in Foreign Exchange Rates)

The request to the IFRS Interpretations Committee (the "Committee") is about how a parent whose functional currency is a currency of a hyperinflationary economy should consolidate a foreign subsidiary whose functional currency is not of a hyperinflationary economy. For clarity the parent applies International Accounting Standard ("IAS") 29 Financial Reporting in Hyperinflationary Economies to prepare its general purpose financial statements.

Background

Since October 2019, entities in [jurisdiction X] with [currency CX] as their functional currency have been applying IAS 29 to prepare their general purpose financial statements. This was after the assessment of the applicability of IAS 29 in [jurisdiction X] concluded that the criteria for assessing whether or not an economy is in hyperinflation as provided for in IAS 29 had been substantially met. This resulted in the pronouncement by [the regulatory body for public accountants and auditors] that there is consensus within the accounting and auditing profession that IAS 29 is now applicable in [jurisdiction X]. To comply with International Financial Reporting Standards, entities in [jurisdiction X], with [currency CX] as their functional currency were required to apply IAS 29, with effect from accounting periods ending on or after.

Fact Pattern

An Entity in [jurisdiction X (entity E)] applies IAS 29 to prepare its general purpose financial statements, which are required to be stated in terms of the measuring unit current at the end of the reporting period. The corresponding figures for the previous period required by IAS 1 Presentation of Financial Statements (as revised in 2007) and any information in respect of earlier periods shall also be stated in terms of the measuring unit current at the end of reporting period. [entity E] has a subsidiary in [jurisdiction Y (subsidiary S)] which prepares its financial statements in accordance with IFRS but does not apply IAS 29 since its functional currency [CY] is not a currency of a hyperinflationary economy. After consolidating the financial statements of [subsidiary S] using guidance of IAS 21 initially and IAS 29 at period end to bring the financial transaction to current measuring unit at period end.

Request

The request asks:

1. Whether [entity E], which is reporting in a currency of a hyperinflationary economy, uses both IAS 21 and IAS 29 or only IAS 21 in the consolidation of current year financial statements of [subsidiary S], which is reporting in a currency of a non-hyperinflationary economy; and
2. Whether [entity E], which is reporting in a currency of a hyperinflationary economy, uses both IAS 21 and IAS 29 or only IAS 21 in the consolidation of the corresponding figures of [subsidiary S], which is reporting in a currency of a non-hyperinflationary economy.

The Divergent Views

There are two perspectives to the issue:

1. The Standards, i.e. IAS 29 and IAS 21 should be applied as they are; and
2. Judgment should be applied in the use of IAS 29 and IAS 21.

The supporting reasoning for each of the above positions is detailed below.

1. The Standards, i.e. IAS 29 and IAS 21 should be applied as they are

IAS 29 paragraph 35 recognises that a parent that reports in the currency of a hyperinflationary economy may have subsidiaries that do not report in the currencies of hyperinflationary economies. The last sentence of IAS 29 para. 35 states, "*The financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21*".

This means that IAS 29 gives no provisions on how to deal with a parent that reports in the currency of a hyperinflationary economy but has subsidiaries that do not report in the currencies of hyperinflationary economies. For guidance on this, IAS 29 refers to IAS 21.

In IAS 21, paragraphs 38 to 47 are pertinent. Specifically, the provisions of para. 39 are relevant to the request. Paragraph 39 reads as follows,

The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:

a) assets and liabilities for each statement of financial position presented (i.e. including comparatives) shall be translated at the closing rate at the date of that statement of financial position;
b) income and expenses for each statement presenting profit or loss and other comprehensive income (i.e. including comparatives) shall be translated at exchange rates at the dates of the transactions; and
c) all resulting exchange differences shall be recognised in other comprehensive income.

The contentious issue is para. 39 (b) on the translation of income and expenses. In this perspective however, there is recognition that although IAS 29 provides a clear reference to IAS 21 for guidance, that reference back to IAS 29 is not available in IAS 21, which has led to two divergent view:

1) The income and expenses for current year are translated to the functional currency of [entity E], whose functional currency is a currency of a hyperinflationary economy using the exchange rates of the dates of transactions, or monthly exchange rate to convert the [CY] income and expenses into [CX] income and expenses. The [CX] translated corresponding figures of [subsidiary S] are consolidated based on [CX] amounts determined in the prior years. No inflation adjustments are applied to the translated [CX] income and expenses This interpretation is based on the literal interpretation of the paragraphs 35 of IAS 29 and Paragraph 39 of IAS 21.

2) The income and expenses are translated to the functional currency of [entity E], whose functional currency is a currency of a hyperinflationary economy using the exchange rates of the dates of transactions, or monthly exchange rate to convert the [CY] income and

expenses into [CX] income and expenses. The [CX] translated corresponding figures of [subsidiary S] are consolidated based on [CX] amounts determined in the prior years. Inflation adjustments are applied to the translated [CX] income and expenses of [subsidiary S], to bring these to the measuring unit current at the end of the reporting period. This interpretation is based on the spirit and key principle of IAS 29, stated in paragraph 8, i.e. "The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy, whether they are based on historical cost approach or a current cost approach, shall be stated in terms of the measuring unit current at the end of the reporting period. The corresponding figures for the previous period required by IAS 1 Presentation of Financial Statements (as revised in 2007) and any information in respect of earlier periods shall also be stated in terms of the measuring unit current at the end of reporting period".

For practical reasons however, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

2. **Judgment should be applied in the use of IAS 29 and IAS 21.**

Assume [subsidiary S] incurred an expense of US$100 in January 2020 when the exchange rate was 16.7734 and [entity E] booked an expense in [CX] functional currency as [CX]1,677.34 in January management accounts. If [entity E] does not apply IAS 29, [entity E] will have a January expense of [CX]1,677.34 in the December Year to Date numbers. Should [entity E] want to convert and present financial statements to a stable currency say the US$, the [CX]1,677.34 rental expense will then become US$20.00 from the original incurred of US$100.00 because of movements in exchange rates and hyperinflation. This amount to an 80% loss in value or understatement of the actual incurred expense in US$ terms. If the original transaction was US$1 million, the loss in value or understatement would be US$800k which will be very material.

To illustrate the flaw in the provided guidance and its pervasiveness to [entity E], [entity E] has a holding company, [holding entity H], which is listed on the [stock exchange in jurisdiction X] and has a functional currency of US$. The holding Company and [entity E's] foreign operation have the same presentation currency however the foreign operation is initially consolidated by [entity E] applying IAS 21 i.e. the exchange rate on the day of the transaction and [holding entity H] then consolidates [entity E] using closing rates.

Working with the example above though [entity E]'s foreign operation would have incurred US$1 million in [jurisdiction Y] and report a US$1 million expense and [holding entity H] will report this expense as US$200k in their financial statements after applying closing rate when they report on the [stock exchange in jurisdiction X], should [entity E] simply apply IAS 21 and disregarding IAS 29.

The purpose of financial statements in terms of IAS 1 is to achieve faithful representation of the transactions, as set out in the conceptual framework. Comparability, which is a key element of fair presentation is not achieved if IAS 29 is not applied.

Having considered the above the critical questions are:

1. Does reporting an actual expense incurred by the foreign operation of US$1 million as US$200k by holding entity H in the same market achieve fair presentation in terms of IAS 1 and the conceptual framework.

Therefore, the application of IAS 21 only and no subsequent application of IAS 29 defeats comparability; a key requirement of financial reporting.

2. The second question is at [entity E] level, does reporting the expense transaction at a rate prevailing on the transaction date ([CX]16,7734) and subsequently not applying IAS 29 achieve fair presentation and comparability.

Our general reading and interpretation of IAS 29 is its main objective is to achieve comparability of financial information for transaction recorded in hyper inflationary economies. It specifically reads, in a hyperinflationary economy, financial statements, whether they are based on a historical cost approach or a current cost approach, are useful only if they are expressed in terms of the measuring unit current at the end of the reporting period.

Consistent with our reading of IAS 29 and IAS 21, a foreign transaction of US$100 incurred in [jurisdiction X] in January at [CX]16.7734 and recorded as [CX]1,677.34 in January is hyper inflated to [CX]7,361 as at 31 December 2020. In substance this is a similar transaction with the US$100 incurred by the foreign operation which is recorded at [CX]1,677.34 and remains [CX]1,677.34. This is not consistent application of IAS 21 and IAS 29 on a similar transaction.

A transaction in January 2020 at prevailing exchange rates of [CY]1,677.34 and not hyper inflated at measuring unit current at 31 December 2020 does not achieve fair presentation.

3. Thirdly, though our interpretation of IFRS may be different, IAS 29 para 10 states that the restatement of financial statements requires the application of certain procedures as well as judgement and that consistent application of these procedures and judgements from period to period is more important than the precise accuracy of the resulting amounts included in the restated financial statements.

At initial adoption of IAS 29, management adopted a position to consolidate the foreign operation by applying IAS 21 initially and applying the IAS 29 to the monthly management accounts at any reporting date be it year-end or half year end. This is to bring foreign transactions to measuring unit current at the end of the reporting period. Management intends to continue to with the initially adopted position in terms of IAS29 para10 and as agreed with the predecessor auditors.

Proposal

Due to the significance of this issue and the divergence of the perspectives in the [jurisdiction X] accounting profession, we propose that this issue be added to the IFRS IC agenda for a discussion of IAS 29 paragraph 35 for a possible revision or clarification of the provision. We propose that this revision should include a statement that the financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with initially in accordance with IAS 21 and subsequently IAS 29.

Under this revision, the last sentence of IAS 29 para. 35 states, "***The financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with initially in accordance with IAS 21, and then subsequently in accordance with IAS 29***".