Project	**Tentative agenda decisions**
Topic	**IAS 29 *Financial Reporting in Hyperinflationary Economies* – Reporting in accordance with IFRSs after a period of chronic hyperinflation**

Purpose of this paper

1. The purpose of this paper is to document the staff analysis and recommendations relating to a request to clarify how an entity should resume presenting financial statements in accordance with IFRSs after a period of chronic hyperinflation when it was unable to comply with IAS 29 *Financial Reporting in Hyperinflationary Economies*.

2. As such, this paper:

   (a) provides background information on this issue;

   (b) analyses the issue within the context of IFRSs;

   (c) makes a staff recommendation on the tentative agenda decision; and

   (d) asks the Committee whether they agree with the staff recommendation.

Background Information

3. The request identifies an entity which presents financial statements in accordance with IFRS and applies IAS 29 because its functional currency is the currency of a hyperinflationary economy (original functional currency).

4. However, at a later date, the general price index relating to the entity's functional currency becomes unavailable because of chronic hyperinflation.

Alternative estimates of the exchange rate are considered unreliable because the currency lacks exchangeability.

5. As a result, the entity no longer prepares and presents financial statements in accordance with IFRS because of its inability to comply with IAS 29, specifically the measurement requirements of IAS 29.11 and IAS 29.26.

6. In a subsequent reporting period, the entity's functional currency changes to a non-hyperinflationary currency (new functional currency) in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

7. Consequently the entity expects to resume preparing and presenting its financial statements in accordance with IFRSs.

8. The request asks the Committee to clarify how an entity in this situation should, after the functional currency changes, resume presenting financial statements in accordance with IFRSs.

9. Specifically, the request asks for guidance on:

    (a) how an entity should present its opening statement of financial position?

    (b) what the entity should present for its comparative financial statements?

Staff Analysis

Current guidance in IFRS

10. IAS 29.1 states that an entity **shall** apply the standard when its functional currency is the currency of a hyperinflationary economy:

> 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. (emphasis added)

11. IAS 29.8 provides the following guidance on how the financial statements of an entity should be presented in accordance with standard:

> ***The financial statements*** of an entity whose functional currency is the currency of a hyperinflationary economy, whether they are based on a 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 the reporting period.*** For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 42(b) and 43 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* apply. (emphasis added)

12. In preparing and presenting financial statements in accordance with IAS 29.11 and IAS 29.26, amounts that are not already expressed in terms of the measuring unit current at the end of the reporting period, should be restated by applying a general price index.

13. When a reliable general price index is unavailable (eg because of chronic inflation), IAS 29.17 implies that an estimate of an appropriate exchange rate should be made.

14. However, in the fact pattern included in the request, exchangeability between an entity's functional currency and an alternative currency does not exist and consequently a reliable exchange rate cannot be estimated.

15. As an alternative, an entity may look to the guidance in IAS 21.26 which requires use of the first subsequent rate at which exchanges could be made. Again though, this rate that does exist.

16. The request notes that in practice, when a reliable general price index is unavailable in a hyperinflationary economy and the functional currency lacks exchangeability, reporting entities:

    (a) cease presenting financial statements in accordance with IFRSs (specifically in relation to the requirements of IAS 29); and

    (b) present their financial statements on a historical cost basis.

17. IAS 29.38 does provide guidance on the presentation of financial statements when an entity ceases to be hyperinflationary. However, IFRSs do not provide specific guidance on how an entity in this situation should, after the functional currency changes, resume presenting financial statements in accordance with IFRSs

How should an entity present its opening statement of financial position?

18. The first issue that arises is how an entity should present its opening statement of financial position at the date of the change in functional currency. The request identifies two views that an entity could adopt.

19. The first view is a proposed amendment to IAS 29 (identified as Option 1 in the request). The second view is a proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards* (identified as Option 2 in the request).

20. Section 4 of the request provides a useful cost benefit comparison of amending either IAS 29 or IFRS 1

21. Some, but not all, of the factors assessed in that comparison are included in the staff analysis below. This includes consideration of the presentation of comparative information, an issue that is separately addressed in this agenda paper.

View 1 - Amendment to IAS 29

22. Proponents of View 1 believe that IAS 29 should be amended.

23. This amendment would require the opening statement of financial position of the entity, after a period of chronic hyperinflation when it was unable to comply with IAS 29 and a change in functional currency, to be presented using fair value as deemed cost.

24. Supporters of this view think that, at the date an entity's functional currency changes to a non-hyperinflationary currency, an entity should prepare a statement of financial position that presents all:

    (a) monetary assets and liabilities in the new functional currency, measured at exchange rates at the date of the opening statement of financial position; and

    (b) non-monetary assets and liabilities in the new functional currency using fair value as deemed cost.

25. They believe this approach for measuring monetary assets and liabilities is consistent with the guidance in IAS 21.37:

> The effect of a change in functional currency is accounted for prospectively. In other words, ***an entity translates all items into the new functional currency using the exchange rate at the date of the change***. The resulting translated amounts for non-monetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously recognised in other comprehensive income in accordance with paragraphs 32 and 39(c) are not reclassified from equity to profit or loss until the disposal of the operation. (emphasis added)

26. Further, they note that due to the non-compliance with IAS 29 in previous reporting periods, reliable measurements of non-monetary assets and liabilities in the entity's original functional currency do not exist, and cannot be translated, at the date of change in functional currency.

27. Consequently, they think the approach for measuring non-monetary assets and liabilities using fair value as deemed cost is consistent with the;

    (a) prospective approach of IAS 21.37;

    (b) guidance in IAS 29.38 which states that

> when an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this Standard, it ***shall treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements***. (emphasis added)

(c) use of fair value as deemed cost exemption in IFRS 1

View 2 - Amendment to IFRS 1

28. Proponents of View 2 believe the opening statement of financial position of the entity, after a period of chronic hyperinflation when it was unable to comply with IAS 29, should, after a change in functional currency, be presented in accordance with IFRS 1.

29. They believe that in accordance with IFRS 1.3, the entity is preparing its first IFRS financial statements.

30. This is because the entity's most recent previous financial statements do not contain an explicit and unreserved statement that they complied with IFRSs because of the requirements of IAS 29.

31. Consequently, the opening statement of financial position, at the date an entity's functional currency changes to a non-hyperinflationary currency, would be presented in accordance with the recognition and measurement guidance in IFRS 1. This includes the ability to apply other exemptions and exceptions in IFRS 1, in addition to the fair value as deemed cost exemption.

Staff view

32. The staff support View 1 that IAS 29 should be amended to require the opening statement of financial position, at the date an entity's functional currency changes to a non-hyperinflationary currency, to be presented using fair value as deemed cost.

33. This reflects the staff belief that this approach:

    (a) is consistent with the notion in IAS 29.38 and IAS 21.37 of a current measurement basis becoming the new carrying amount for non-monetary assets and liabilities;

(b) would address the issue for both an entity operating in a hyperinflationary economy (eg a subsidiary in Zimbabwe), and a parent entity which may operate in a different jurisdiction that does not have a hyperinflationary economy (eg a parent in South Africa).

This is because the parent entity may not meet the scope of IFRS 1 when presenting its financial statements.

(c) avoids concerns regarding the application of IFRS 1 in this situation. These concerns include whether an entity:

(i) can apply IFRS 1 more than once. [1]

(ii) could comply with all of the requirements of IFRS 1 in preparing and presenting its first financial statements after the change in functional currency.

This includes the requirements in IFRS 1 relating to comparative information (discussed below) and the measurement of non-monetary assets and liabilities when IFRS 1 does not include specific related exemptions.

(iii) should be able to apply all of the exemptions and exceptions in IFRS 1.

34. The staff also considered whether the amendment should be made to IAS 21, rather than IAS 29, because the issue arises as a result of an entity's functional currency changing.

35. However, the staff think that the issue arises primarily as a result of the entity operating in a hyperinflationary economy. The change in the entity's functional currency is a consequence of the hyperinflationary economy, rather than the cause of the specific issue.

[1] Refer to the agenda paper 'Repeat Application of IFRS 1' prepared for the May IFRS Interpretations Committee meeting for further details.

What should the entity present for its comparative financial statements?

36. Once an entity has determined how it should prepare and present its opening statement of financial position at the date the functional currency changes, it is required to consider the preparation and presentation of comparative financial statements (comparatives).

37. For example, assume that on 31 March 20X3 the functional currency of an entity with a reporting date of 31 December changes in accordance with the fact pattern identified in the request.

38. It then applies the amendment proposed in this agenda paper to prepare an opening statement of financial position in accordance with IFRSs on 31 March 20X3, the date of the change in functional currency.

39. The entity then expects to present a closing statement of financial position at 31 December 20X3 and a statement of comprehensive income for the period 31 March 20X3 to 31 December 20X3 in accordance with IFRSs.

40. However, when presenting financial statements at 31 December 20X3, questions arise as to;

    (a) what the entity should present for comparative periods prior to 31 March 20X3; and

    (b) whether these comparatives are in accordance with IFRSs.

41. The issue arises because:

    (a) the entity is unable to provide IFRS compliant comparatives due to its non-compliance with IAS 29 (and potentially other IFRSs);

    (b) guidance in IAS 21.37 for presenting financial statements after a change in functional currency requires prospective application and does not prescribe changes to the presentation of comparatives; and

    (c) reliable general price indices, or exchange rates between the entity's new and original functional currency, are not available in comparative periods.

42. Consequently, potential alternatives for the presentation of comparatives include:

(a) **Historical cost basis**

Presentation on a historical cost basis is consistent with how the staff understands practice has developed for presenting financial statements when an entity cannot comply with the requirements of IAS 29.

(b) **Using the exchange rate at the date of the opening statement of financial position**

This approach would require comparative amounts to be presented based upon the exchange rate between the new and original functional currency at the date of the change in functional currency.

This is consistent with the guidance for presenting corresponding figures in IAS 29.34 but conflicts with the fact that previous financial statements could **not** be presented in accordance with IAS 29.

(c) **Presentation of transactions, assets and liabilities if denominated in a currency other than the original functional currency**

The comparative financial statements could include only the presentation of transactions, assets and liabilities that are denominated in a currency that can be translated in accordance with IAS 21. Amounts denominated in an entity's original functional currency would be presented as zero balances.

We understand that this proposal has been discussed in practice, specifically in relation to monetary transactions.

(d) **Requiring that no comparatives are presented**

Amending IFRSs to require that the entity should not present comparatives would avoid the presentation of unreliable and potentially confusing financial information.

It could also allow an entity to present financial statements in compliance with IFRSs after the change in functional currency (ie in the 31 December 20X3 financial statements in the example above)

However, it would be inconsistent with the general requirements in IAS 1 *Presentation of Financial Statements* relating to comparative information.

(e) **Not providing guidance in IFRS**

This approach would not require IFRSs to provide additional guidance on comparatives presentation and would avoid introducing a specific exception into IFRSs to address the presentation of comparative information in this situation.

43. The staff support the view that IFRSs should **not** provide additional guidance on the presentation of comparatives in this situation.

44. The staff do not believe that IFRSs should prescribe a required format for presentation of comparatives that creates an exception to guidance in current IFRSs.

45. Additionally, the staff are concerned whether an alternative format for presentation of comparatives could always meet the purpose of financial statements in IAS 1 to provide information that is useful to a wide range if users.

46. As a result, the staff believe that constituents should continue to apply the current guidance in IFRSs in presenting comparatives. If an entity cannot comply with this guidance, as may likely be the case in this situation, those comparatives should not be considered to be compliant with IFRSs.

47. The staff acknowledge that this approach could lead to an accounting choice developing in practice, with some entities electing to present comparatives that are not compliant with IFRS (eg on a historical cost basis) and others electing not to present comparatives at all.

48. However the staff believe it is appropriate for an entity to exercise judgement in determining what comparatives should be presented based on an assessment of what would be most useful to users of their specific financial statements.

Other considerations

49. If an amendment is made to IAS 29 to provide guidance on presenting the opening statement of financial position, but additional guidance on the presentation of comparative information is not provided, an additional question arises.

50. This is highlighted by continuing through the example above into reporting periods after 31 December 20X3.

51. If we assume that the entity cannot provide comparative information in accordance with IFRSs in its 31 December 20X3 financial statements, then these financial statements cannot contain an explicit and unreserved statement of compliance with IFRSs.

52. However, the entity would expect to be able to present financial statements that are in compliance with IFRSs, including full comparative information, at a later date (eg 31 December 20X4 or 31 December 20X5).

53. As a result, by applying the proposed amendment to IAS 29, the entity begins the process towards presenting a complete set of financial statements in accordance with IAS 1, including the required comparative information.

54. Consequently, an entity may determine that, in a reporting period subsequent to the date of the functional currency changes (eg 31 December 20X4 or 31 December 20X5), it will be able to present financial statements in full compliance with IFRSs.

55. The question that arises is whether, in this subsequent reporting period, the entity may be required to apply IFRS 1 because these financial statements represent the entity's first IFRS financial statements.

56. The staff do not believe it would be appropriate for an entity to apply IFRS 1 because of the proposal to amend IAS 29 to address this specific situation.

57. Instead, the staff propose an amendment to the scope of IFRS 1 to exclude application of the standard in this specific situation.

Staff Recommendation

58. The staff recommend that IAS 29 should be amended.

59. The staff think the amendment to IAS 29 should:

(a) only be applied in the specific circumstances identified in the request.

(b) provide guidance on the preparation and presentation of the opening statement of financial position on a fair value as deemed cost basis.

(c) not provide additional guidance on comparative information.

(d) clarify that this situation should not lead to an entity applying IFRS 1 in a subsequent reporting period.

60. The staff also recommend an amendment to the scope of IFRS 1 to exclude application of the standard in this specific situation.

Agenda criteria assessment for the committee

61. The staff's preliminary assessment of the agenda criteria is as follows:

(a) The issue is widespread and has practical relevance.

Yes.

The staff think the issue is widespread in certain hyperinflationary economies and has practical relevance.

(b) The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.

Yes.

The staff believe that current IFRSs do not specifically address this issue. As a result divergence in practice is emerging.

(c) Financial reporting would be improved through elimination of the diverse reporting methods.

Yes.

Financial reporting would be improved through the elimination of these diverse reporting methods.

(d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

No.

The staff believe the most efficient way of resolving the issue would be through an amendment to current IFRSs and not through the interpretation process.

This is because the staff think the issue identifies a specific gap that exists in current IFRSs.

(e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

Yes. It is probable that the Committee would be able to reach a consensus on these issues on a timely basis.

(f) *If the issue relates to a current or planned IASB project, there is a pressing need to provide guidance sooner than would be expected from the IASB's activities. The committee will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the committee requires to complete its due process.*

Not applicable.

The IASB does not have any current or planned projects on its agenda that are expected to address these issues.

62. Based on the assessment of the agenda criteria, the staff recommend that the Committee should not add the issue to its agenda but should recommend that the Board amend IFRSs.

Annual Improvements criteria assessment

Assessment against currently used criteria

63. The existing criteria for inclusion in the 2009-2011 *Annual Improvements Process* (*AIP*) cycle are that the proposed amendment is <u>non-urgent</u> and <u>necessary</u>.

64. The staff believe this is a necessary amendment to IFRSs.

65. However the staff do not think the amendment meets the existing criteria for inclusion in the 2009-2011 *AIP*. This is because the proposed amendment is:

    (a) introducing a new principle which does not currently exist in IFRSs; and

    (b) urgent.

        Many entities presenting financial statements in the economy identified in the request are expected to identify changes in their functional currency in the first quarter of 2010.

        An amendment made as part of the 2009-2011 *AIP* would not be issued until the second quarter of 2011, with an expected effective date of 1 January 2012. This issuance and effective date would be too late to be useful to the hyperinflationary economy identified in the request.

66. Therefore the staff propose that the Committee recommend the Board make a separate amendment to IAS 29 to address this issue which could be issued on a more timely basis.

Effective date and transition

67. The staff think an entity should apply the amendments at the date the entity changes its functionary currency to a new, non-hyperinflationary, currency.

68. The amendments should be applied on a prospective basis at this date.

69. Prospective application is consistent with requirement of IAS 21.37 which requires an entity to apply translation procedures prospectively when it changes functional currency.

70. Additionally, an entity would be unable to apply the amendments retrospectively because it can not obtain a reliable exchange rate before the date of change in functional currency.

71. The staff propose that an entity shall apply the amendments for annual periods beginning on or after 1 January 2011. Earlier application shall be permitted which is expected to be useful to the entities operating in the hyperinflationary economy identified in the request. If an entity applies the amendment for an earlier period it shall disclose that fact.

72. The proposed wording for the tentative agenda decision is set out in Appendix A. The proposed wording for the amendments to IAS 29 and IFRS 1, and the Basis for Conclusions are in Appendix B.

Question 1 for the Committee
1. Does the Committee agree with the staff's recommendation that the Committee should recommend the Board make an amendment to IAS 29 and to IFRS 1 to address this issue? 2. Does the Committee have any comments on the proposed wording for the tentative agenda decision in Appendix A or for the amendments in Appendix B?

Appendix A – Proposed wording for agenda decision

A1. The Staff proposes the following wording for the **tentative** agenda decision:

> **IAS 29 *Financial Reporting in Hyperinflationary Economies* – Reporting in accordance with IFRSs after a period of chronic Hyperinflation**
>
> The Committee received a request for clarification on how an entity should resume presenting financial statements in accordance with IFRSs after a period when it did not comply with IAS 29.
>
> The request identifies an entity whose functional currency is the currency of a hyperinflationary economy. The entity is unable to comply with IAS 29 because the general price index relating to the entity's functional currency is unavailable and the functional currency lacks exchangeability. The entity's functional currency then changes to a non-hyperinflationary currency.
>
> The Committee noted that current IFRSs do not provide guidance relating to the issue.
>
> The Committee concluded that IAS 29 should be amended to require an entity in this specific situation to prepare and present an opening statement of financial position on a fair value as deemed cost basis. The amendment should also clarify that an entity should not apply IFRS 1 *First-time Adoption of International Financial Reporting Standards* in this situation.
>
> Comparative information should continue to be prepared and presented in accordance with current IFRSs.
>
> The Committee [decided] not to add the issue to its agenda but to recommend that the Board amend IAS 29 and IFRS 1 to address the issue.

Appendix B – Proposed amendment to IAS 29 *Financial Reporting in Hyperinflationary Economies*

Paragraph 38A-38D and 41A are added.

Change in functional currency

38A An entity may discontinue the preparation and presentation of financial statements in accordance with this Standard because it is unable to restate financial statements by applying a general price index. This is because the general price index relating to the entity's functional currency is unavailable and the functional currency lacks exchangeability.

38B Additionally, an entity's functional currency may change to the currency of a non-hyperinflationary economy in accordance with IAS 21.

38C When, and only when, paragraphs 38A and 38B apply to an entity, the entity shall at the date of the change in functional currency:

(a) prepare an opening IFRS statement of financial position.

(b) measure each non-monetary item in its new functional currency at its fair value and use that fair value as its deemed cost.

(c) translate each monetary item into the new functional currency.

(d) recognise any resulting adjustments arising from paragraphs 38C(b) and 38C(c) directly in retained earnings (or, if appropriate, another category of equity).

38D An entity shall not apply IFRS 1 First-time adoption of International Financial Reporting Standards when preparing and presenting financial statements for reporting periods when both paragraphs 38A and 38B apply.

Effective date

41A An entity shall apply paragraphs 38A – 38D for annual periods beginning on or after 1 January 2011 on a prospective basis from the date of the change in functional currency. Earlier application is permitted. If an entity applies paragraphs 38A – 38D in its financial statements for a period beginning before 1 January 2011, it shall disclose that fact.

Appendix to proposed amendment to IAS 29
Amendment to other IFRSs

IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph 4(d) is added.

Scope

(d) presents comparative information in accordance with paragraphs 38A and 38B of IAS 29 *Financial Reporting in Hyperinflationary Economies*.

Basis for Conclusions on proposed amendment to IAS 29 *Financial Reporting in Hyperinflationary Economies*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

BC1 In 2010 the IFRS Interpretations Committee received a request to clarify how an entity should resume presenting financial statements in accordance with IFRSs after a period when it did not comply with IAS 29 *Financial Reporting in Hyperinflationary Economies*.

BC2 The request identified a situation when an entity can no longer comply with IAS 29 because the general price index relating to the entity's functional currency becomes unavailable and the functional currency lacks exchangeability. The reporting entity's functional currency then changes to a non-hyperinflationary currency and the entity considers how it can resume presenting financial statements in accordance with IFRSs.

BC3 The IFRS Interpretations Committee concluded that IFRSs do not address how an entity should resume presenting financial statements in accordance with IFRSs in this situation and recommended that the Board amend IAS 29.

BC4 The Board determined that it was appropriate to amend IAS 29 to address this issue because it only arises when an entity's previous functional currency is the currency of a hyperinflationary economy.

BC5 The Board decided that to resume presenting financial statements in accordance with IFRSs, an entity should prepare a statement of financial position at the date of the change in functional currency.

BC6 In this statement of financial position, the entity should measure each non-monetary item in its new functional currency at its fair value and use that fair value as its deemed cost and translate each monetary item into the new functional currency. This is consistent with the prospective accounting applied for a change in functional currency in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

BC7 The Board also decided that in this situation an entity should not apply IFRS 1 *First-time Adoption of International Financial Reporting Standards*. This is because of the specific guidance provided in IAS 29.

Appendix C – Agenda request

C1. The staff received the following Committee agenda requests. All information has been copied without modification by the staff.

1 Project Objective

Non-compliance with IFRS

Zimbabwean entities have prepared financial statements in accordance with International Financial Reporting Standards (IFRSs) and its predecessor, International Accounting Standards (IASs), since the early 1970s. For financial reporting purposes the Zimbabwean currency (the Zimbabwean Dollar) became a hyperinflationary currency, as defined, in early 2001.

The economic situation in Zimbabwe significantly worsened during 2007 and 2008, resulting in the view of many Zimbabwean entities (preparers), users and auditors that compliance with IFRS was not possible, as:

(i) the indices used for financial reporting in Zimbabwe's hyperinflationary economy ceased to be published after July 2008 because prices could not be obtained for the entire CPI basket of goods as the majority of formal shops were empty;

(ii) attempts to convert Zimbabwean Dollars (ZWD) to other recognised currencies gave rise to unreliable and misleading results because of the wide spread of exchange rates available in the economy;

(iii) attempts to obtain ZWD fair values using present value/discounting models were severely hampered by inconsistent and unrealistic discount (interest) rates giving rise to unreliable and misleading results;

(iv) the Zimbabwe Stock Exchange (ZSE) did not operate from mid-November 2008 to mid-February 2009 which meant that there were no ZWD market-observable prices.

The road towards compliance with IFRS

The Zimbabwean economy was effectively 'dollarised' on 29 January 2009 when the Zimbabwean national budget was presented in United States Dollars (USD) alongside the ZWD. The 'dollarisation' of the Zimbabwean economy represents a change in the transactions, events and conditions that Zimbabwean entities are exposed to subsequent to the presentation of the national budget. As such the majority of entities in Zimbabwe changed their functional currency to the USD.

The use of the USD has normalised the financial reporting of Zimbabwean entities post-January 2009, but the challenge remains how to determine an entity's opening carrying amounts in USD on the date of its change in functional currency. As the relevant standards of IFRS (IAS 29 & IAS 21) were not drafted with the extreme conditions of the Zimbabwean economy in mind; it has been suggested that amendments to IFRS be put forward to the International Accounting Standards Board (IASB) for consideration.

The following potential options are explored in this discussion paper:

Option 1 – Amendment to IAS 29

Option 2 – Amendment to IFRS 1

2 Background

As noted above, the Zimbabwean currency (the ZWD) became a hyperinflationary currency, as defined in IAS 29 "Financial Reporting in Hyperinflationary Economies" ("IAS 29"), in early 2001 due to the cumulative inflation rate over a three year period exceeding 100%. The ZWD in March 2007 reached levels described as chronic hyperinflation or economic hyperinflation based on Phillip Cagan's (1956) definition of hyperinflation being inflation in excess of 50% per month.

As a consequence of Zimbabwe's chronic hyperinflation, the ZWD was re-based on three separate occasions:

- August 2006 – The first ZWD was replaced by the second ZWD, at a rate of 1,000 old ZWD = 1 new ZWD (3 zero removed)
- August 2008 – The second ZWD was replaced by the third ZWD, at a rate of 10,000,000,000, old ZWD = 1 new ZWD (10 zeros removed)
- February 2009 – The third ZWD was replaced by the fourth ZWD, at a rate of 1,000,000,000,000 old ZWD = 1 new ZWD (12 zeros removed)

The key accounting challenges that were encountered in Zimbabwe from 2001 onwards were the application of IAS 21 "The Effects of Changes in Foreign Exchange Rates" ("IAS 21"), which assumes that there is a single spot rate prevailing in the economy at a single point in time, and the application of IAS 29 which assumes that a general price index is available and is reflective of the level of price changes in the general economy. The logic and validity of the assumptions underlying IAS 21 and IAS 29 can be compromised in an environment where the exchange rate and product prices are artificially legislated. This resulted in multiple official and unofficial (parallel) exchange rates and parallel market prices for products subject to price controls.

<u>Multiple exchange rates</u>

Within the Zimbabwean economy numerous estimates of the exchange rate existed prior to January 2009 and the following are a sample of the common exchange rate estimates:

- Old Mutual Implied Rate (OMIR) – an exchange rate implied by comparing the ZWD price and British Pound Sterling (GBP) price of a dual-listed share, in this case the Old Mutual plc share which is listed on the Zimbabwean and the London stock exchanges;
- Parallel market rate – a 'street' cash exchange rate;
- Official Reserve Bank rate – entities in Zimbabwe were forced to sell a percentage of their foreign currency receipts to the

Month	**Average ZWD to 1 USD (OMIR)**	**Average ZWD to 1 USD ("cash rate")**
Mar-08	42,904,410	34,309,285
Apr-08	101,641,267	74,759,851
May-08	362,551,900	302,911,456
Jun-08	20,776,401,940	6,866,824,105
Jul-08	307,453,608,696	67,273,356,522
(ZWD was redenominated on 1 Aug 08 – 10 zeros removed)		
Aug-08	312	88
Sep-08	88,431	578
Oct-08	159,269,899,330	31,041
Nov-08	75,700,617,933,333,300	773,367
Dec-08	13,091,290,322,580,600	629,748,387

Source – developed from the LSE, the ZSE and Zfn daily bulletins of the range of market rates

Reserve Bank at an official exchange rate which was kept artificially low;

- Electronic funds transfer rate – a rate available for overnight delivery between commercial banks and their customers; and
- PPC Implied Rate (PPCIR) – an exchange rate implied by comparing the ZWD price and South African Rand (ZAR) price of a dual-listed share, in this case the PPC Limited share which is listed on the Zimbabwean and the Johannesburg stock exchanges;

The ZSE closed on 19 November 2008, resulting in the predominate exchange rate, the OMIR, ceasing to exist. The ZSE only re-opened in February 2009, but all shares were now trading in USD.

<u>The general price index</u>

Entities in Zimbabwe are required in terms of IAS 29 to restate their ZWD historical cost financial information to the current measurement unit at the end of the reporting period, such that the financial statements reflect the purchase power parity of non-monetary items across periods. The Zimbabwean economy has since 2001 used the Consumer Price Index (CPI) published by the Central Statistical Office as the general price index utilised for the preparation of hyper inflated financial statements.

When Zimbabwe entered hyperinflation in early 2001 the level of activity on the parallel market was significantly less than when Zimbabwe entered the period of chronic hyperinflation. The significantly increased level of activity on the parallel market, particularly within foreign currency transactions, led to severe distortions within the economy, and the reliability of the CPI diminished as the inflation levels reached exponential levels.

As a result of the perceived distortions within the CPI, many entities abandoned the preparation of IAS 29 hyper inflated financial statements, and produced historical cost financial statements on which a modified audit opinion was expressed by their auditors due to non-compliance with IFRS.

CONSUMER PRICE INDEX: OFFICIAL FIGURES FROM CENTRAL STATISTICAL OFFICE

Date	Monthly % increases	Year-on-year % increases
Mar-07	51	2,200
Apr-07	101	3,714
May-07	55	4,530
Jun-07	86	7,251
Jul-07	32	7,635
Aug-07	12	6,593
Sep-07	39	7,982
Oct-07	136	14,840
Nov-07	131	26,471
Dec-07	240	66,219
Jan-08	121	100,520
Feb-08	126	164,850
Mar-08	224	354,950
Apr-08	314	735,118
May-08	380	2,263,284
Jun-08	827	11,268,759
Jul-08	2,600	231,162,000
From Aug-08	No information released by the Central Statistical Office	

Source - John Robertson, leading Zimbabwean economist

The Central Statistical Office ceased publishing an official CPI in ZWD from August 2008 because prices could not be obtained for an entire CPI basket of goods as the majority of shops were empty. The Central Statistical Office has restarted publishing an official CPI index and month-on-month inflation based on USD prices from January 2009.

<u>Date of change of functional currency from the ZWD to 'hard currency'</u>

The Zimbabwean economy was 'dollarised' on 29 January 2009 when the Zimbabwean national budget was presented in USD alongside the ZWD. The Governor of the Reserve Bank of Zimbabwe announced the relaxing of exchange control regulations on 2 February 2009, which would permit all entities in Zimbabwe to trade in foreign currencies.

IAS 21 states that once an entity's functional currency has been determined it is not changed unless there is a change in the underlying transactions, events and conditions within the economy in which the entity operates [IAS 21.13]. The 'dollarisation' of the Zimbabwean economy represents a change in the transactions, events and conditions that Zimbabwean entities are exposed to subsequent to the speech. The evaluation of an entity's functional currency needs to be performed based on the economic indicators applicable to the entity. As a result, the majority of entities in Zimbabwe have changed their functional currency to the USD.

The date of change in functional currency will vary from entity to entity. Although the official announcement was only made at the end of January 2009, a limited number of entities were transacting in foreign currency at an earlier date, as the Reserve Bank of Zimbabwe had responded to the issue of unmanageable ZWD prices by issuing licences to trade in foreign currencies to certain entities that could meet the conditions. Trading in foreign currency in Zimbabwe was subject to exchange control approval where an entity did not have such a certificate.

Note: No single one currency dominates trade within Zimbabwe, with trade denominated in different currencies on a city/regional basis. In the remainder of this paper reference is made to the United States Dollar (USD) as the currency of reporting subsequent to the change in functional currency, but equally the South African Rand (ZAR) or the Botswana Pula (BWP), or another stable currency may be the functional currency of the reporting entity.

3 Project Scope and Approach

Purpose: The main purpose of this project is to discuss how Zimbabwean entities might return to compliance with IFRS.
Approach: This project proposes to develop two options for consideration by the Accounting Practices Committees (APCs) of the South African Institute of Chartered Accountants (SAICA) and the Institute of Chartered Accountants of Zimbabwe (ICAZ). It is intended that ultimately the selected approach or approaches will be submitted to the IASB for their consideration.
Options: The options to be considered are detailed in the Appendices to this document and are as follows:

- Option 1 – Amendment to IAS 29 – refer to Appendix A for further details

  Under this option we are suggesting an amendment to IAS 29, whereby on the date an entity changes its functional currency (in accordance with IAS 21) to a non-hyperinflationary currency, all the non-monetary assets and liabilities will be revalued in the new functional currency. This would represent the assets and liabilities current cost on ceasing to apply IAS 29. This is similar to the current guidance provided by ICAZ to its members, except that detailed guidance would not be provided on how individual assets and liabilities would be measured.
  The scope of the amendment will be narrow in that it would only deal with situations such as those currently experienced by Zimbabwe (change from chronic hyper-inflation to another functional currency). The suggested draft change would be the inclusion of a paragraph under the heading 'economies ceasing to be hyperinflationary' which would provide clear guidance as to how to account for such a change. The guidance provided

would state that the revalued non-monetary assets and liabilities will be treated in the same manner as IAS 29 restated cost, i.e. this current cost measure is treated as cost. Entities applying the amendment will do so retrospectively, but the proposed amendment will only affect an entity from the date of change of the entity's functional currency to a stable currency.

- Option 2 – Amendment to IFRS 1 – refer to Appendix B for further details

  Under this option we are suggesting an amendment to the scope of IFRS 1, for situations where an entity previously prepared IFRS financial statements and is unable to apply the requirements of IAS 29 for a period of time and in the interim period applies another basis of preparation. The reason for non application of IAS 29 is due to the entity not being able to comply with IFRS, because the official inflation indices have become unreliable or not determinable due to chronic hyperinflation, extreme volatility in the markets and a general collapse of the formal economy. In order to restore the economy, the country abandons its local currency and permits entities to use any other recognised currency in settling and recording transactions. In such cases we believe IFRS 1 may be an appropriate route to transition back onto IFRS, even though the entity had applied IFRS in the past.

4 Key discussion points

Considerations	Option 1	Option 2
Cost of implementation	This may be a costly option as a valuator may need to be required to obtain appropriate values for all non-monetary assets.	It may be a costly consideration as a full IFRS conversion exercise will need to be undertaken.
Application of the exemptions to group entities	This option provides relief to both the investor and the investee. Entities which have Zimbabwean subsidiaries will be able to use the exemption in their consolidated financial statements.	This option may only assist Zimbabwean companies in returning to IFRS. This option would not provide relief to parent entities with Zimbabwean subsidiaries that are already reporting under IFRS.
Determination of fair value or replacement values	Fair values or replacement values determined under the circumstances in Zimbabwe may not be considered reliable and concerns over market observability of the assumptions may be questionable.	Fair values or replacement values determined under the circumstances in Zimbabwe may not be considered reliable and concerns over market observability of the assumptions may be questionable.
Comparative periods	This option does not provide relief to entities before the date of change of functional currency. As such comparative	Where an exemption is not available IFRS 1 requires an entity to apply IAS 29 and IAS 21 on a retrospective basis.

Considerations	Option 1	Option 2
	information prepared in ZWD would continue to be subject to the same accounting restrictions described in this paper.	This option does not provide relief to entities before the date of change of functional currency. As such comparative information prepared in ZWD would continue to subject to the same accounting restrictions described in this paper.
Ability for the exemption to be applied by analogy	The exemption is limited to territories that have suffered chronic hyperinflation. The exemption will not be applied by entities in countries where there is hyper inflation, but there are adequate indices (or estimates thereof).	Applying IFRS 1 to previous IFRS reporters may result in abuse of IFRS 1 other purposes. Therefore, the proposed amendments seek to define criteria that would need to be met before this could be applied.
Limitations	The exemption does not deal with the accounting dilemma faced during the period of chronic hyperinflation, i.e. it can only be prospectively applied from the date of change of functional currency.	IFRS 1 has only limited exemptions and cannot be applied to all non-monetary assets. The greatest relief is provided for property, plant and equipment. Where an exemption is not available, IAS 29 and IAS 21 would be required to be complied with.

Appendix A: Option 1 - Amendment to IAS 29

Executive summary of option

1. Under this option we are suggesting an amendment to IAS 29, whereby on the date an entity changes its functional currency (in accordance with IAS 21) to a non-hyperinflationary currency, all the non-monetary assets and liabilities will be revalued in the new functional currency. This would represent the assets and liabilities current cost on ceasing to apply IAS 29. This is similar to the current guidance provided by ICAZ to its members, except that detailed guidance would not be provided on how individual assets and liabilities would be measured.

2. The scope of the amendment will be narrow in that it would only deal with situations such as those currently experienced by Zimbabwe (change from chronic hyper-inflation to another functional currency). The suggested draft change would be the inclusion of a paragraph under the heading 'economies ceasing to be hyperinflationary' which would provide clear guidance as to how to account for such a change. The guidance provided would state that the revalued non-monetary assets and liabilities will be treated in the same manner as IAS 29 restated cost, i.e. this current cost measure is treated as cost. Entities applying the amendment will do so retrospectively, but the proposed amendment will only affect an entity from the date of change of the entity's functional currency to a stable currency.

Technical rationale for amendment

3. The purpose of restating financial statements in hyperinflationary economies in accordance with IAS 29 is to reflect the effect on an entity of changes in general purchasing power. Paragraph 2 of IAS 29 states:

   "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."

4. For financial reporting purposes the Zimbabwean currency (the Zimbabwean Dollar) became a hyperinflationary currency, as defined, in early 2001. In order to give effect to the objective of IAS 29, the Zimbabwean economy has since 2001 used the Consumer Price Index (CPI) published by the Central Statistical Office of Zimbabwe as the general price index utilised for the purposes of measuring current cost (in Zimbabwean Dollars) within hyper-inflated financial statements.

5. During March 2007 inflation in Zimbabwean Dollars reached levels described as chronic hyperinflation with inflation in excess of 50% per month. By the time the Central Statistical Office ceased publishing official CPI in Zimbabwean Dollars in August 2008 inflation had reached 231.1 million percent per annum (2,600 percent per month). The Central Statistical Office ceased publishing the official CPI, because prices could not be obtained for entire CPI basket of goods as the majority of shops were empty.

6. During the period beyond July 2008, there were several independent estimates of inflation which were all based on mathematical models; however as the mode of settlement which the data was based on are inconsistent, the range of the estimates is very wide. By way of example, John Robertson, a leading Zimbabwean economist, estimated the monthly inflation in November 2008 (which appeared to be the peak of Zimbabwe's inflation) as 5.7

billion per cent, whilst Paul Hanke of the Cato Institute, estimated monthly inflation in the same month at 79.6 billion per cent. These estimates are based on settling transactions via electronic payments and the share prices of dual listed equities.

7. As a result of the perceived distortions within the official CPI index and the wide range of CPI estimates, many entities abandoned the preparation of IAS 29 hyper inflated financial statements, and produced historical cost financial statements on which a modified audit opinion was expressed by their auditors due to non-compliance with IFRS. Many prepares, users, and auditors have stated that IFRS and in particular IAS 29 was not drafted with the chronic hyperinflation of Zimbabwe in mind.

8. The Zimbabwean economy was effectively 'dollarised' on 29 January 2009 when the Zimbabwean national budget was presented in United States Dollars (USD) alongside the Zimbabwean Dollar. The Governor of the Reserve Bank of Zimbabwe announced on 2 February 2009 the relaxing of exchange control regulations, which would permit all entities in Zimbabwe to trade in foreign currencies.

9. IAS 21 paragraph 13 states that once an entity's functional currency has been determined it is not changed unless there is a change in the underlying transactions, events and conditions within the economy in which the entity operates:

   "An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions".

10. IAS 21 paragraph 14 enforces the application of the above principle in an economy which is hyper-inflationary, by stating that an entity cannot avoid the application of IAS 29 if its functional currency is a currency that is considered to be hyperinflationary as defined in IAS 29:

    "If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated in accordance with IAS 29 Financial Reporting in Hyperinflationary Economies. An entity cannot avoid restatement in accordance with IAS 29 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its parent)."

11. Therefore, until such time as the general economic conditions in Zimbabwe changed during January 2009; the majority of Zimbabwean entities regarded the ZWD as their functional currency as they were required by law to transact in ZWD. The 'dollarisation' of the Zimbabwean economy during January 2009 represents a change in the transactions, events and conditions that Zimbabwean entities are exposed to. As a result, the majority of entities in Zimbabwe have since January 2009 changed their functional currency to the USD.

12. Where an entity's functional currency is the currency of a hyperinflationary economy, it is required by IAS 21 paragraph 43 to first restate its financial statements in accordance with IAS 29, before translating the financial statements into another currency. Paragraph 43 refers to situations where an entity is translating financial statements prepared in a hyperinflationary currency into a different presentation currency, but this paragraph would equally apply to the translation of hyperinflationary balances into a new non-hyperinflationary functional currency on the date of such change in accordance with IAS 21 paragraphs 35 to 37.

13. Two challenges arise in determining the restatement of financial statements to a measuring unit current at the date of change of functional currency and translation into the entity's new functional currency:

    a. The general price index (CPI) is not available from July 2008 and is considered to be unreliable due to the shortage of goods in the economy and the effect of controlled prices; and

    b. The lack of exchangeability between the ZWD and other currencies, because of the severe foreign exchange restrictions in force before January 2009. In addition a significant mechanism of exchange between ZWD and other currencies was effectively removed when the trading in dual listed shares ceased at the time of closing of the ZSE.

14. IFRS does have exemptions that deal with the temporary unavailability of a general price index and the lack of exchangeability between currencies. IAS 29 considers situations when a general price index is not available. Paragraph 17 states:

    "A general price index may not be available for the periods for which the restatement of property, plant and equipment is required by this Standard. In these circumstances, it may be necessary to use an estimate based, for example, on the movements in the exchange rate between the functional currency and a relatively stable foreign currency"

15. In the case of Zimbabwe, there is a wide range of estimates of the prevailing exchange rates. Subsequent to October 2008, the exchangeability of the ZWD became extremely limited, as the ZWD started to cease being used as a medium of exchange.

16. IAS 21 provides guidance on how an entity should deal with situations where exchangeability between two currencies is lacking. Paragraph 26 states:

    "When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made."

17. The challenge in applying IAS 21 paragraph 26 within the Zimbabwean context is the fact that no subsequent rate exists at which exchanges could be made. On the 12 April 2009, the ZWD was indefinitely suspended and all bank notes ceased to be legal tender. All balances denominated in ZWD have economically ceased to exist subsequent to the 'dollarisation' of the economy and have no value within the 'dollarised' economy. Therefore, Zimbabwean entities are unable to determine a general price index from July 2008, either directly by reference to prices of goods in the economy or indirectly by using the movements in the exchange rate.

18. Based on current IFRS literature, Zimbabwean entities are required to make an estimate of the general price index prevailing within the Zimbabwean economy for the period from July 2008, until the entity changes its functional currency in order to restate its financial statements for the effect of changes in general purchasing power. The current cost ZWD carrying amounts would then be translated at an estimated exchange rate. The range of estimates available for both the general price index and the exchange rate results in a distortion of the opening USD based financial information. These opening balances will continues to distort Zimbabwean financial statements for the foreseeable future.

19. As a consequence of the dysfunctional nature of the Zimbabwean economy and the lack of a general price index and exchangeability of the ZWD, it is proposed that an amendment to IAS 29 be proposed to cater for the extremely rare circumstances that have occurred within the Zimbabwean economy.

20. This exemption should not be available in countries where there is hyperinflation, and adequate indices are available or could be reliably estimated using the relief provided in IAS 29 paragraph 17. The economy should lack both a reliable general price index and the exchangeability of its currency should have permanently ceased, or at least ceased for a significant period of time.

<u>Suggested draft wording for the amendment</u>

21. Proposed amendment to IAS 29 *Financial Reporting in Hyperinflationary Economies*

Paragraph 38A is added. Paragraph 38 is not proposed for amendment but is included here for ease of reference.

Economies ceasing to be hyperinflationary

38 When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this Standard, it shall treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.

38A <u>Where the currency of a hyperinflationary economy ceases to be used as a medium of exchange and exchangeability between the economy’s currency and other currencies no longer exists, and the economy lacks a reliable general price index; it may be necessary to estimate the effect of restatement for changes in purchasing power and the conversion of the resulting balances into the entity’s new functional currency by the use of valuations determined in the new functional currency.</u>

Paragraph 41A is added. Paragraph 41 is not proposed for amendment but is included here for ease of reference.

Effective date

41 This Standard becomes operative for financial statements covering periods beginning on or after 1 January 1990.

41A <u>An entity shall apply paragraph 38B for annual periods beginning on or after 1 January 2011. Earlier application is permitted. If an entity applies paragraph 38B for an earlier period, it shall disclose that fact.</u>

<u>Suggested Basis for Conclusion on the amendment</u>

22. **Basis for Conclusions**

This Basis for Conclusions accompanies, but is not part of, the proposed amendments to IAS 29.

BC 1 This Basis for Conclusions summarises the International Accounting Standards Board’s considerations in proposing amendments to IAS 29 *Financial Reporting in Hyperinflationary Economies*. Individual Board members gave greater weight to some factors than to others.

BC 2 The Board was asked by users, preparers, and auditors of financial statements to provide guidance on how the impact of changes in general prices levels and changes in foreign currency exchange rates should be applied within an economy which became increasingly abnormal and majority of transactions took place via barter trade.

BC 3 Where the economic fundamentals of an economy result in the lack of published statistics and a wide range of estimates; users, preparers, and auditors have questioned the reliability of financial statements prepared based on such estimates of inflation and foreign currency exchange rates required to be made in accordance with IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29.

BC 4 The estimation of changes in general price levels and changes in foreign currency rates are central to the preparation of financial statements prepared in a hyperinflationary currency. Though the Board appreciates the difficulty in estimating the changes in general price levels and changes in foreign currency rates it does not believe that it is appropriate to amend the general requirements of IAS 21 and IAS 29, as the principles contained within the standards are conceptually sound.

BC 5 IAS 29 allows for the estimation of a general price index by reference to changes in foreign exchange movements. This approach is unable to be implemented in the Zimbabwean context due to the lack of exchangeability between the Zimbabwe Dollar and other currencies. Because the lack of exchangeability is permanent in nature and not merely temporary, the ability to use the first subsequent rate at which exchanges could be made in accordance with IAS 21 paragraph 26 is also unavailable for use.

BC 6 The Board proposes amending IAS 29 such that in extremely rare circumstances, such as those experienced in Zimbabwe, entities should be provided with an exemption from preparing current cost financial statements in a measuring unit current as at the date of change in functional currency and then translating those financial statements into a stable non-hyperinflationary currency using the exchange rate prevailing on the date of change of functional currency.

BC 7 In these circumstances; entities should be allowed to measure the opening carrying amount in its new functional currency using independent professional valuations similar to the exemption allowed under paragraph 16 of IAS 29 for an entity's first hyper inflated financial statements.

<u>Suggested examples/application guidance</u>

23. No suggested examples/application guidance is recommended to be included with the amendment.

Appendix B: Appendix B: Amendment to IFRS 1

<u>Executive summary of option</u>

1. Under option 2 we thought it might be appropriate to include within the scope of IFRS 1, situations where an entity previously prepared IFRS financial statements

and is unable to apply the requirements of IAS 29 for a period of time and in the interim period applies another basis of preparation. The reason for non application of IAS 29 is due to the entity not being able to comply with IFRS, because the official inflation indices have become unreliable or not determinable due to chronic hyperinflation, extreme volatility in the markets and a general collapse of the formal economy. In order to restore the economy, the country abandons its local currency and permits entities to use any other recognised currency in settling and recording transactions. In such cases we believe IFRS 1 may be an appropriate route to transition back onto IFRS, even though the entity had applied IFRS in the past.

2. It is proposed that situations in which it is not possible to generate meaningful financial statements, be defined in standard and be treated as if the entity did not previously present IFRS financial statements.

3. BC67 may need to be amended to allow for an exemption for not having to restate comparatives for hyperinflation. If the deemed cost exemption is not taken or available on first time adoption, this would require the application of hyperinflation accounting which will result in non-compliance with IFRS as the entity is unable to apply IAS 29.

4. If the deemed cost exemption is used, paragraph D8 of IFRS 1 permits an entity to use, as the deemed cost, the fair values for its assets and liabilities that arose from 'an event-driven valuation'. In the guidance prepared by ICAZ a fair value exercise is required, which could viewed as 'an event-driven valuation'.

Technical rationale for amendment

5. If an economy experiences chronic hyperinflation, characterised by month on month inflation in excess of 50%, coupled with extreme volatility in its markets, the ability to develop a single reliable general price index required by IAS 29 is hindered significantly. In such circumstances that produced chronic hyperinflation, it is highly likely that determining a reliable spot rate as required by IAS 21 will be impracticable. In the recent example in Zimbabwe, it was noted that it was impossible to develop a single reliable general price index or a reliable spot rate, and accordingly it became impossible to apply IAS 29 and IAS 21. Hence it was impossible for entities that reported in Zimbabwe dollars to be IFRS compliant. In such circumstances, it is highly likely that:

    a. The results reported in such circumstances are likely to be unreliable and misleading, not only due to the fundamental distortions within the economy which would have given rise to such circumstances (i.e. political interference in markets, price regulations and the rise of informal markets which are not transparent), but also because it is unlikely that such results will be generated before general prices have changed significantly.

    b. Either such a currency will be replaced, or a significant event will occur that will trigger the re-measurement of assets and liabilities if such a currency is stabilised.

6. In such circumstances, as were experienced in Zimbabwe in late 2008, entities that reported under IFRS would be unable to make an explicit and unreserved statement that they complied with IFRSs. In Zimbabwe the adoption of alternative currencies was considered a

significant event and in an attempt to ensure comparability, and reasonable results, the local accounting body recommended that entities in this environment measure all their assets and liabilities at their fair value on the particular date that they adopted a new currency.

7. When the currency ceases to be hyperinflationary, or an entity adopts a new currency, the current IFRS 1 requires such an entity to apply the accounting policies that were already adopted, and then reconcile the "opening IFRS statement of financial position" to these results. Where an entity has not been able to apply IAS 29 in an economy experiencing chronic hyperinflation, it would not be able to comply with its former accounting policies, and the equity balance is highly likely to be misleading and unreliable. Consequently, reconciling to this number would be meaningless.

8. For the period within the chronic hyperinflation environment, it is unlikely that an entity could prepare meaningful financial information for the reasons described above, and consequently to the extent that it covers this period, the comparative information would be misleading.

9. Paragraph 3 (a) (iii) of IFRS 1 states that "Financial statements in accordance with IFRSs are an entity's first IFRS financial statements if, for example, the entity... presented its most recent previous financial statements... containing an explicit statement of compliance with some, but not all, IFRSs". Accordingly, it appears that an entity can report under IFRS for a period, then report under a modified IFRS, as was the forced case in Zimbabwe as it was not able to comply with all the IFRSs. In the year following this period, such an entity would be required to apply IFRS 1 as "its most recent previous financial statements contained an explicit statement of compliance with some, but not all, IFRSs".

10. For the circumstances similar to those experienced in Zimbabwe, where it was impossible for entities to prepare fully IFRS compliant financial statements, it is proposed that such a situation be treated as if an entity had not presented IFRS financial statements for previous periods. Consequently it is proposed that paragraph 28 in IFRS 1 be expanded, and the basis of conclusions that comments on hyperinflation be expanded to allow for a situation where no reliable general price index is available and there is no reliable spot exchange rate.

<u>Suggested draft wording for the amendment</u>

11. Proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph 28A is added. Paragraph 28 is not proposed for amendment but is included here for ease of reference.

28. If an entity did not present financial statements for previous periods, its first IFRS financial statements shall disclose that fact.

28A. <u>In the extremely rare circumstances where an entity has not been able to prepare IFRS compliant financial statements because the requirements of certain standards are not available (for instance, the absence of a reliable general price index as required by IAS 29, the absence of a reliable spot exchange rate as required by IAS 21 and the absence of a reliable discount rate), then when the conditions exist again for full IFRS compliance, it should apply paragraphs 13–19 and Appendices B–E, to</u>

estimate (a) a new statement of financial position and (b) to estimate comparative figures for IAS 1.

[or]

28A. In the extremely rare circumstances where an entity has not been able to prepare IFRS compliant financial statements because the requirements of certain standards are not available (for instance, the absence of a reliable general price index as required by IAS 29, and the absence of a reliable spot rate as required by IAS 21 and the absence of a reliable discount rate), then its first IFRS financial statements shall disclose that fact.

Suggested Basis for Conclusion on the amendment

12. This Basis for Conclusions accompanies, but is not part of, the proposed amendments to IFRS 1, it is suggested that it would be included as an expansion of BC67 which addresses the Basis for Conclusion that considers hyperinflation.

HYPERINFLATION

BC67. Some argued that the cost of restating financial statements for the effects of hyperinflation in periods before the date of transition to IFRSs would exceed the benefits, particularly if the currency is no longer hyperinflationary. However, the Board concluded that such restatement should be required, because hyperinflation can make unadjusted financial statements meaningless or misleading.

BC67A. An entity in a hyperinflationary economy may be unable to comply with the requirements of IAS 29 for a period of time because the official inflation indices have become unreliable or not determinable due to chronic hyperinflation (for example, month on month inflation above 50%) and extreme volatility in the markets. If in the interim period such an entity applies another basis of preparation that includes measuring all of its assets and liabilities at their fair value at one particular date in a new functional currency, it may use such fair value measurements as deemed cost for IFRSs at the date of that measurement.

Suggested examples/application guidance

Background

The end of entity A's first IFRS reporting period is 31 December 20X10. Entity A decides to present comparative information in those financial statements for one year only (see paragraph 36). Therefore, its date of transition to IFRSs is the beginning of business on 1 January 20X9 (or, equivalently, close of business on 31 December 20X8). Entity A presented financial statements under IFRS annually to 31 December each year up to, and including, 31 December 20X7, however was unable to comply with all IFRSs in presenting its financial statements in 31 December 20X8 due to the absence of a reliable general price index or a reliable spot exchange rate in an economy experiencing chronic hyperinflation.

Application of requirements

Entity A is required to apply the IFRSs effective for periods ending on 31 December 20X1 in:

(a) preparing its opening IFRS statement of financial position at 1 January 20X10; and

(b) preparing and presenting its statement of financial position for 31 December 20X10 (including comparative amounts for 20X9), statement of comprehensive income, statement of changes in equity and cash flow statement for the year to 31 December 20X10 (including comparative amounts for 20X9) and disclosures (including comparative information for 20X9).

No reconciliation is necessary for the opening IFRS statement of financial position; however the method applied in the measurement of all assets and liabilities should be fully disclosed. The circumstances that led to the inability for Entity to comply with all IFRSs in its financial statements in 31 December 20X8 should be disclosed.