Project: **Amendment to IFRS 1 – *First-time Adoption of International Financial Reporting Standards***

Topic: **Presenting IFRS financial statements after a period of severe hyperinflation**

Appendix A – Proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

Paragraph D1 is amended (new text is underlined and deleted text is struck through). Paragraphs D26 – D29 and paragraph 39G is added.

Appendix D

Exemptions from other IFRSs

D1 An entity may elect to use one or more of the following exemptions:

(o) transfers of assets from customers (paragraph D24).
(p) extinguishing financial liabilities with equity instruments (paragraph D25).
<u>(q) severe hyperinflation (paragraphs D26-D29).</u>

An entity shall not apply these exemptions by analogy to other items.

Severe hyperinflation

D26 If a first-time adopter applies IAS 29 *Financial Reporting in Hyperinflationary Economies* it shall determine whether it is subject to severe hyperinflation.

D27 The currency of a hyperinflationary economy is subject to severe hyperinflation if it has both of the following characteristics:

(a) A reliable general price index is not available to all entities with transactions and balances in the currency.

(b) Exchangeability between the currency and a relatively stable foreign currency does not exist.

D28 An entity's functional currency ceases to be subject to severe hyperinflation on the functional currency normalisation date. This is when the functional currency no longer has either, or both, of the characteristics in paragraph D27, or when there is a change in the entity's functional currency to a currency that is not subject to severe hyperinflation.

D29 When an entity's date of transition to IFRS is the functional currency normalisation date, the entity may elect to measure all assets and liabilities at fair value and use that fair value as its deemed cost at that date.

Presentation and disclosure

Use of deemed cost after severe hyperinflation

31B If an entity elects to measure assets and liabilities at fair value and use that fair value as its deemed cost in its opening IFRS statement of financial position because of severe hyperinflation (see paragraphs D26–D29), the entity's first IFRS financial statements shall disclose an explanation of how, and why, the entity had, and then ceased to have, a functional currency that has both of the following characteristics:

(a) A reliable general price index is not available to all entities with transactions and balances in the currency.
(b) Exchangeability between the currency and a relatively stable foreign currency does not exist.

Effective date

39G *Additional Exemption for First-time Adopters – Severe Hyperinflation* (Amendments to IFRS 1), issued in [date], amended paragraph D1 and added paragraphs D26-D29. An entity shall apply those amendments for annual periods beginning on or after 1 July 2011. Earlier application is permitted. If an entity applies those amendments for an earlier period, it shall disclose that fact.

Basis for Conclusions on proposed amendment to IFRS 1 *First-time Adoption of International Financial Reporting Standards*

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

Introduction

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 of severe hyperinflation, during which it had been unable to comply with IAS 29 *Financial Reporting in Hyperinflationary Economies*.

BC2 The request identifies an entity whose functional currency is the currency of a hyperinflationary economy. The entity is unable, for a period of time, to comply with IAS 29 and prepare financial statements in accordance with IFRSs because of severe hyperinflation. This is because a reliable general price index is not available to all entities, and exchangeability between the currency and a relatively stable foreign currency does not exist.

BC3 The request asks how such an entity should resume preparing financial statements under IFRSs when the entity's functional currency subsequently ceases to be the currency of a severe hyperinflationary economy.

Decision to amend IFRS 1

BC4 The IFRS Interpretations Committee observed that an entity with the functional currency of a hyperinflationary economy cannot comply with IFRSs if a reliable general price index is not available because of the requirements in paragraph 37 of IAS 29 to restate financial statements using a general price index. Furthermore, the absence of exchangeability between an entity's functional currency and a relatively stable currency eliminates a potential alternative to using a general price index.

BC5 The IFRS Interpretations Committee noted that once the functional currency of the entity ceases to have both of these characteristics, IFRSs do not provide guidance on how an entity should resume presenting financial statements in accordance with IFRSs in this situation. Specifically, the IFRS Interpretations Committee noted that an entity cannot comply with all of the requirements in IFRS 1 to prepare and present an opening IFRS statement of financial position. Consequently, the IFRS Interpretations Committee recommended that the Board should amend IFRSs to address this issue.

BC6 The Board [agreed] with the IFRS Interpretations Committee that current IFRSs do not provide guidance on how an entity should resume presenting financial statements in accordance with IFRSs after a period when its functional currency was subject to severe hyperinflation. Consequently, the Board [decided] to amend IFRSs to provide guidance.

BC7 The Board considered whether it was appropriate to amend IFRS 1 or IAS 29 to address this issue. The Board noted that an amendment to IAS 29 would reinforce the intent that the amendment should be very narrow and limited to the situation where an entity meets the scope of IAS 29. Furthermore, an amendment to IAS 29 could also be applied by an entity with an interest in an entity that emerges from a severe hyperinflationary economy, not just an entity that previously suffered from severe hyperinflation. The Board identified that these entities would be unable to apply guidance in IFRS 1 if they had continued to prepare and present financial statements in accordance with IFRSs during the period that the entity they held an interest in was subject to severe hyperinflation.

BC8 However, in considering the amendment, the Board understood additional concerns that interested parties have with applying the current scope of IAS 29 and with proposals to change IAS 29 only to address this issue of severe hyperinflation. Additionally, the Board understood from interested parties that this is not a significant and or widespread issue for entities with interests in entities that had a functional currency that was subject to severe hyperinflation.

BC9 Therefore, the Board [decided] to amend IFRS 1. The Board observed that this would enable it to provide timely guidance to those entities that were unable, for a period of time, to comply with IAS 29 and prepare financial statements in accordance with IFRSs because of severe hyperinflation. The Board [decided] that it was unnecessary to provide additional guidance to interests in entities that had a functional currency that was subject to severe hyperinflation because of the current guidance that exists in IFRSs.

BC10 The Board [proposed] to amend IFRS 1 to provide guidance on how an entity can resume preparing IFRS financial statements by presenting an opening IFRS statement of financial position at the functional currency normalisation date. This is the date when the entity's functional currency ceases to suffer from severe hyperinflation. The Board identified that the characteristics of severe hyperinflation make it challenging to provide guidance that would result in the presentation of reliable financial information that could be considered IFRS-compliant during the period of severe hyperinflation. The Board also noted that providing further flexibility on when an entity should apply the amendment would not provide users with comparable financial information and would be inconsistent with the notion that the functional currency normalisation date is the event that created the need for additional guidance.

Accounting at the functional currency normalisation date

BC11 The Board [determined] that an entity that was subject to severe hyperinflation may elect to measure assets and liabilities at fair value and use that fair value as its deemed cost in its opening IFRS statement of financial position. The Board believes this approach expands the deemed cost exemptions that currently exist in the Standard to enable them to be applied in these specific circumstances. The Board thinks this provides a practical solution to providing guidance on how an entity can resume presenting financial statements in accordance with IFRSs, and consequently apply IFRS 1, after being subject to severe hyperinflation. The Board also acknowledged that the use of a historical cost measurement basis would not provide reliable financial information because of the impact of severe hyperinflation in previous reporting periods.

BC14 The Board [decided] that any adjustments arising on electing to measure assets and liabilities at fair value in the opening IFRS statement of financial position arise from events and transactions before the functional currency normalisation date. Consequently, they should be accounted for in accordance with paragraph 11 of the Standard, and an entity should recognise those adjustments directly into retained earnings (or, if appropriate, another category of equity) at the date of transition to IFRSs. Therefore, the Board [determined] there was not a need for further guidance on the accounting for those adjustments.

BC14 The Board observed that entities that were subject to severe hyperinflation may face challenges in applying paragraph 21 of the Standard to prepare and present comparative information in accordance with IFRSs for periods before the functional currency stabilisation date. The Board noted that an entity should clearly present and disclose any challenges it faces by explaining the transition to IFRSs in accordance with paragraphs 23–28.

Appendix B – Background information

B1. The requestor identifies a situation in Zimbabwe as severe hyperinflation where an entity can not comply with IAS 29 because the general price index relating to the entity's functional currency is unavailable and there is no exchangeability with a relatively stable currency.

B2. This appendix provides some details on the severe hyperinflation that existed in the Zimbabwean economy.

The general price index

B3. 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.

B4. The CPI had been observed as bellow since March 2007

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		

B5. 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.

B6. 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.

B7. 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.

B8. The Central Statistical Office has restarted publishing an official CPI index and month-on-month inflation based on USD prices from January 2009.

Exchangeability with a relatively stable currency

B9. 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:

(a) 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;

(b) Parallel market rate – a 'street' cash exchange rate;

(c) Official Reserve Bank rate – entities in Zimbabwe were forced to sell a percentage of their foreign currency receipts to the Reserve Bank at an official exchange rate which was kept artificially low;

(d) Electronic funds transfer rate – a rate available for overnight delivery between commercial banks and their customers; and

(e) 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;

B10. The table below shows Zimbabwean dollar's exchange rate against US dollars from March 2008 to December 2008

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

B11. The Zimbabwe Stock Exchange (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.