Project	**Amendment to IFRS 1 – *First-time Adoption of International Financial Reporting Standards***
Topic	**Presenting IFRS financial statements after a period of severe hyperinflation**

Purpose of this paper

1. The purpose of this paper is to document the staff analysis and recommendations relating to a request received by the IFRS Interpretations Committee (Interpretations Committee) 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*.

2. The request identifies an entity whose functional currency is the currency of a hyperinflationary economy.

3. The entity is unable, for a period of time, to comply with IAS 29 and prepare financial statements in accordance with IFRSs, because the general price index relating to the entity's functional currency is unavailable, and the functional currency lacks exchangeability.

4. The request identifies this situation as 'chronic hyperinflation' (this agenda paper uses the term 'severe hyperinflation'). The request asks how such an entity should resume presenting financial statements in accordance with IFRSs when the entity's functional currency subsequently ceases to be the currency of a severely hyperinflationary economy, specifically because the entity does not have IFRS-compliant comparative information.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

5. The request notes the current applicability of this fact pattern when presenting IFRS financial statements for entities that previously had the Zimbabwe dollar (a currency that suffered from severe hyperinflation) as their functional currency, or when preparing consolidated financial statements for entities with an interest in such entities.

6. In the July 2010 meeting, the Interpretations Committee recommended that the Board should make a separate amendment to address this issue, and to enable guidance to be issued on a timely basis in order to assist the jurisdiction identified in the request.

7. The Board discussed the recommendations made by the Interpretations Committee in the July 2010 IASB meeting and requested the staff to perform additional work as follows:

   (a) analysis of whether, in the consolidated financial statements of parents, venturers and investors, differences arising on application of the proposed guidance should be recognised in profit or loss or as a component of equity;

   (b) further outreach with jurisdictions that have been subject to hyperinflation;

   (c) research on the number of entities in jurisdictions applying IFRSs that are currently affected by severe hyperinflation; and

   (d) considering whether the accounting for an entity subject to severe hyperinflation should be addressed separately from the accounting for an entity with an interest that is subject to severe hyperinflation.

8. In response, this paper:

   (a) provides background information on this issue;

   (b) analyses the issues that in the July Board meeting the Board asked the staff to perform additional work on;

   (c) makes a revised staff recommendation on the next steps relating to this project; and

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

Background Information

9. At the May 2010 meeting[1] , the Interpretations Committee noted that current IFRSs do not provide guidance relating to this issue, and that it is not possible to prepare financial statements in accordance with IFRSs during a period of severe hyperinflation.

10. The Interpretations Committee discussed the issue further in the July 2010 meeting[2]. Consequently the Interpretations Committee tentatively concluded that IAS 29 should be amended to provide guidance on how an entity shall prepare and present an IFRS opening statement of financial position at the date when the entity's functional currency ceases to be the currency of a severe hyperinflationary economy. The Interpretations Committee tentatively decided to recommend that the Board should make a separate amendment to IAS 29 to address this issue.

11. This amendment would:

    (a) apply at the date that an entity's functional currency no longer suffers from severe hyperinflation;

    (b) deem the reporting entity to have a new accounting basis at this date; and

    (c) require the reporting entity to apply the recognition and measurement principles in IFRS 3 *Business Combinations*, subject to certain exceptions, at this date.

[1] See Agenda Paper 12 of the May 2010 IFRS Interpretations Committee Meeting : http://www.iasb.org/Meetings/IFRIC+Meeting+6+May+2010.htm
[2] See Agenda Paper 12 of the July 2010 IFRS Interpretations Committee Meeting: http://www.ifrs.org/Meetings/rustees+Meeting+06072010.htm

12. At the July meeting[3], the Board discussed the recommendation from the Interpretations Committee to amend IAS 29 and requested that the staff should perform additional work relating to this issue.

Staff Analysis

13. The staff analysis of the issues that the Board requested the staff addresses after the July 2010 Board meeting is included below.

Recognition of differences arising on application of the proposed guidance

Reporting entity is subject to severe hyperinflation

14. When a reporting entity is subject to severe hyperinflation, the Interpretations Committee recommended that any differences arising on application of the proposed guidance, based on the principle of measuring assets and liabilities at fair value, should be recognised as a hyperinflation reserve, separately from other components of equity.

15. This hyperinflation reserve is calculated as the net amount of the assets, liabilities and other components of equity that are recognised and measured at the date the guidance is applied.

16. The Interpretation Committee's recommended that this difference should be recognised in a severe hyperinflation reserve as a component of equity because:

    (a) similarly to the guidance in paragraph 11 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, this difference arises from events and transactions before the date that the entity's function currency no longer suffers from severe hyperinflation;

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[3] See Agenda Paper 13 of the July 2010 the International Accounting Standards Board Meeting: [IASB Board Meeting 21 July 2010]

(b) the entity has a new accounting basis on the date when it applies the guidance and is not required to present IFRS-compliant financial information for the periods when the entity's functional currency was suffering from severe hyperinflation. Consequently, the difference cannot be attributed to the reporting entity's previous IFRS profit or loss because it is not presented; and

(c) they analogise to the reserve arising on a revaluation event, similar to reserves attributed to the revaluation of assets such as property, plant and equipment, intangible assets and certain financial assets.

17. The Interpretations Committee proposes that because this reserve arises in specific circumstances, it should be identified separately from other components of equity, but not as a component of other comprehensive income.

18. Guidance on whether this hyperinflation reserve is distributable would not be provided. This is because the staff believe that the ability of an entity to distribute the reserve will depend upon the legal and statutory requirements of the reporting entity's jurisdiction.

Reporting entity has an interest in an entity subject to severe hyperinflation

19. When a reporting entity has an **interest** in an entity subject to severe hyperinflation, the Interpretations Committee recommended that any differences arising on application of any proposed guidance relating to this situation should be recognised in profit or loss, and not as a component of equity.

20. The staff believe that recognition of any difference in profit or loss of the entity holding an interest is consistent with the:

(a) accounting treatment for the loss of control of a subsidiary described in paragraph 34 (e) of IAS 27 *Consolidated and Separate Financial Statements*.

The Interpretations Committee noted that a number of reporting entities deconsolidated interests in entities that were subject to severe hyperinflation because the circumstances relating to the severe hyperinflation economy contributed to the reporting entity losing control (eg because of changes in government regulation).

(b) requirements for recognising impairment losses on cash-generating units in paragraph 60 of IAS 36 *Impairment of Assets*.

The Interpretations Committee noted that many entities with an interest would have recorded impairments in profit or loss in previous reporting periods because of the impacts of the severe hyperinflation on the value in use, or fair value, of their interests.

(c) recognition of a gain arising on a bargain purchase transaction in accordance with paragraph 35 of IFRS 3.

(d) view that the differences relate to a change in the measurement of the reporting entity's interest, and consequently a change in accounting estimates, which should be accounted for in accordance with paragraph 36 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

21. The Interpretations Committee believe that the recognition of any difference in profit or loss is appropriate, even though the difference is reflected in equity in the financial statements of the entity that is subject to severe hyperinflation. This reflects the differences in the situation that exist; specifically, that the:

(a) entity holding an interest continues to present comparative IFRS financial statements that include financial information relating to the entity during the period that it suffered from severe hyperinflation;

(b) adjustments relate to changes in the measurement of existing assets and liabilities, rather than differences arising on the initial recognition of new assets and liabilities; and

(c) guidance would create comparability between the accounting for the differences by all entities holding interest, regardless of whether or not they consolidated the entity before, or after, it had a functional currency that was subject to severe hyperinflation.

Further outreach with jurisdictions that have been subject to hyperinflation

22. At the July 2010 IASB meeting, the Board discussed the implications of the recommendation made by the Interpretations Committee to address this issue by an amendment to IAS 29.

23. In these discussions, some members of the Board identified that constituents in South America have identified practical concerns with implementing the current guidance in IAS 29. Consequently, the Board requested that the staff should conduct additional outreach with these constituents to obtain feedback from them on the proposals.

24. As a result, after the July 2010 Board meeting, the staff performed further outreach and determined that the most significant concerns that these constituents have with IAS 29 also relate to the scope of the standard.

25. In a severe hyperinflation situation, an entity remains within the scope of IAS 29, but there is a lack of guidance in the standard relating to how the entity can apply the requirements.

26. In contrast, the most significant concerns raised by South American constituents relate to a perception that the scope of the standard is too restrictive. Consequently, entities that believe that they would provide better-quality IFRS financial statements if they were to apply IAS 29, are unable to apply the standard.

27. The staff understand that these views will be discussed in the September National Standard Setters (NSS) meeting and have asked for an update on the feedback received when the issue is discussed with the NSS.

28. Although both of these concerns relate to the scope of IAS 29, the staff believe that the two issues raised are very different.

29. The staff also discussed the views of South American constituents on the specific recommendations made by the Interpretations Committee in relation to severe hyperinflation.

30. In these discussions, the staff noted that this constituent group are concerned that the proposals will not require entities to present IFRS-compliant comparative financial information. They believe that, in this situation, the IASB should encourage entities to prepare comparative financial information, even if it is not IFRS-compliant, or provide entities with specific guidance on how IFRS-compliant information can be presented during periods when the entity's functional currency suffers from severe hyperinflation.

31. The staff note that the Interpretations Committee had a number of concerns relating to how an entity could provide IFRS-compliant information during the period when was suffering from severe hyperinflation. This included whether it could be:

    (a) presented in a reliable and consistent manner; and

    (b) prepared without the use of hindsight.

32. Consequently, the staff continue to believe that entities should be encouraged to provide disclosures relating to the periods when the entity had a currency that was subject to severe hyperinflation, but clearly state the basis upon which they are presented (which is unlikely to be in accordance with IFRSs).

Entities affected by severe hyperinflation

33. The Interpretations Committee observed that the issues relating to severe hyperinflation were identified by entities, or reporting entities with an interest in entities, that previously had the Zimbabwe Dollar as a functional currency. Further details on the background to the issues in Zimbabwe are presented in Appendix B.

34. According to the staff's outreach, there are around 100 entities listed in Zimbabwe and are consequently required to prepare financial statements in accordance with IFRSs. In addition, the staff understand that there are a number of subsidiary entities of both Zimbabwe-listed parents, and foreign parents, that are required to prepare IFRS financial statements. We understand that most of

these entities have had a period of time when their functional currency suffered from severe hyperinflation.

35. In addition we understand that there are a number of entities that are expecting to apply IFRS for SMEs. We understand that, for these entities, many of the challenges currently faced will be resolved because of the requirements and timeline for first-time adoption of IFRS for SMEs.

36. The deliberations of the Interpretations Committee were significantly influenced by concerns that any proposed guidance should assist not only those entities that have a functional currency that suffers from severe hyperinflation, but also those entities that hold an interest in such entities.

37. In these deliberations, the Interpretations Committee acknowledged that the need for guidance on the accounting for these entities may be less because:

    (a) the issue may not always be material; and

    (b) current IFRSs may already provide guidance that can be applied (for example guidance relating to loss of control situations and accounting for associates).

38. Based on additional outreach, the staff understand that the majority of reporting entities that hold interests in entities subject to severe hyperinflation have been able to apply current IFRSs to account for the issues that severe hyperinflation creates. In addition, we understand that, based on a review of disclosures that the financial statement impacts are material for only a single-digit number of these IFRS reporting entities.

39. As a result, the additional outreach we have performed indicates that:

    (a) there remains a significant need for guidance that entities that previously had the Zimbabwe Dollar as a functional currency can apply to assist them with the transition back to IFRSs; and

    (b) there is a less pressing need to provide specific guidance to entities with an interest in such entities, although additional guidance would create further consistency in the application of IFRSs.

40. Although the above outreach focuses on Zimbabwe, where the issue of severe hyperinflation has been identified, the staff also believe that this analysis would also apply in the context of other IFRS jurisdictions that may be subject to severe hyperinflation in the future.

Separate guidance on the accounting for an entity subject to severe hyperinflation

Amendment to IAS 29

41. At the July 2010 Board meeting, the staff proposed that IAS 29 should be amended to address this issue, reflecting the recommendation of the Interpretations Committee, because:

    (a) it reinforces the Interpretation Committee's view that the scope of the amendment should be very narrow and limited to the situation where an entity meets the scope criteria of IAS 29; and

    (b) an entity with an interest in an entity that emerges from a severe hyperinflationary economy, not only the entity that previously suffered from severe hyperinflation, would be able to apply this amendment.

42. However, the staff acknowledge that concerns exist relating to the proposals to amend IAS 29. These include concerns that:

    (a) other constituents have identified other issues with the scope of IAS 29 that some believe should be addressed in combination with the severe hyperinflation issue;

    (b) the issue does not appear to be significant and widespread for entities with interests in entities that had a functional currency that was subject to severe hyperinflation. Consequently, there seems to be limited benefit to providing additional guidance, specifically given the complexities that may exist (eg whether differences should be presented in profit or loss or within equity) in determining the form of any additional guidance; and

(c) guidance may not be available in time for entities reporting at 31 December 2010. This is because of the length of the comment period that may be required for amendments to IAS 29 because of the nature of the standard. This would significantly reduce the usefulness of the proposed amendments.

Amendment to IFRS 1

43. After considering the additional feedback received from constituents, the staff recommend that IFRS 1, and not IAS 29, should be amended. This is because the staff believe that the:

(a) extent of the guidance proposed should be reduced. Specifically, the staff believe that the amendment should focus only on providing guidance for entities that are subject to severe hyperinflation, not for entities with interests in such entities;

(b) issues that relate to entities with interests in entities that suffer from severe hyperinflation can be considered together with other IAS 29-specific issues that have been raised by constituents at a later point in time;

(c) more limited amendment to IFRS 1 may be issued on a more timely basis, with a shorter comment period. For example, other recent amendments to IFRS 1 have been issued with a 60-day comment period; and

(d) amendment to IFRS 1 would be consistent with the proposal to clarify that IFRS 1 may be applied more than once as part of the *Annual Improvements Process*. The Interpretations Committee finalised the agenda decision to make this recommendation to the Board after making their recommendation on the accounting for severe hyperinflation.

44. The staff think that an amendment to IFRS 1 can be scoped in a narrowly defined manner, retaining a scope that relates specifically to IAS 29, without creating an exemption that may be applied in wider situations.

Revisions to the proposed amendment

45. The staff have made some changes to the proposed wording of the amendment proposed at the July 2010 Board meeting.

46. The most significant changes made are to propose that the amendment should:

    (a) be made to IFRS 1, not IAS 29;

    (b) apply only to those entities that have a functional currency that ceases to be subject to severe hyperinflation (not to those entities that have interests in such entities);

    (c) clarify that the scope only applies when there is no exchangeability with **a relatively stable currency**; and

    (d) use the term **currency normalisation date**, rather than currency stabilisation date.

47. The revised proposed wording for the amendments to IFRS 1, and for the Basis for Conclusions, are in Appendix A.

Transition and effective date

48. The staff propose that an entity shall apply the amendment prospectively when preparing and presenting an opening statement of financial position on, or after, 1 July 2011. The staff note that this opening statement of financial position would be prepared at, or shortly after, the currency stabilisation date.

49. Earlier application should be permitted, which is expected to be useful to the entities operating in the hyperinflationary economy identified in the request.

Consequential amendments

50. The staff do not think that consequential amendments would be needed, because the guidance would only apply when the entity is preparing its first IFRS financial statements.

Staff conclusion

51. The staff recommend that the Board should proceed with an amendment to IFRS 1 to address this issue.

52. Although this issue has arisen primarily in only one IFRS jurisdiction, the staff believe that it highlights a gap that exists in current IFRS. The proposed amendment is narrow in nature and will address the gap that exists in IFRS 1 without creating a conflict or an exception to principles included in other IFRSs.

53. As a result of the outreach, the staff understand this proposed amendment to IFRS 1 would be very useful if available for application before 31 December 2010, avoiding the emergence of divergent practices.

54. Consequently, the staff propose the following tentative timeline for finalising this amendment in order to maximise its usefulness to constituents:

    (a) if the Board agree with the staff recommendations , an Exposure Draft of the amendment is published in early October 2010, with a 60-day comment period;

    (b) comments received on the Exposure Draft are redeliberated at the December 2010 IASB meeting; and

    (c) the amendment is issued in January 2010, with an effective date of 1 July 2011. Earlier application should be permitted.

55. The staff believe that this timeline would allow calendar year entities in Zimbabwe to apply the amendment in their 31 December 2010 financial statements.

Questions for the Board
1. Does the Board agree with the Interpretation Committee's recommendation that the Board should make an amendment to IFRS 1 to address this issue? 2. Does the Board have any comments on the proposed wording for the amendment to IFRS 1 in Appendix A? 3. Does the Board agree with the publication of an Exposure Draft with an accelerated 60-day comment period?