Special Commission created by the
Federación Argentina de Consejos Profesionales de Ciencias Económicas

Research Paper
Inflation

September 2010

This Research Paper was prepared by the Special Commission created by the Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE) on March 19, 2009 and made up of the following members:

Fermín del Valle (chairman)

Fernando Casals

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The paper contains proposals for inflation accounting. For convenience purposes, it is presented in the format of a "Preliminary Draft" of an International Financial Reporting Standard (IFRS) that could replace IAS 29 *Financial Reporting in Hyperinflationary Economies*.

Comments on this paper were required to the Conselho Federal de Contabilidade (CFC), the Instituto dos Auditores Independentes do Brasil (IBRACON), the Colegio de Contadores de Chile, the Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF), the Colegio de Contadores, Economistas y Administradores del Uruguay (CCEAU), the Federación de Colegios de Contadores Públicos de Venezuela (FCCPV), Mr. Amaro Gomes, member of the International Accounting Standards Board (IASB), Mr. Jan Engstrom, member of the IASB and Mr. Wayne Upton, Director of International Activities of the IASB.

Comments were received from the Comité de Pronunciamentos Contábeis do Brasil (CPC)[1], the Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF) and the Colegio de Contadores de Chile.

All the comments received were considered. A summary of the comments not incorporated in the Commission's proposals is presented in page 31.

[1] This is the Brazilian accounting standard setter, of which the Conselho Federal de Contabilidade (CFC) and the Instituto dos Auditores Independentes do Brasil (IBRACON) are members.

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CONTENTS

Introduction

IN1 This Research Paper contains proposals on inflation accounting that were developed by the Special Commission created by the Federación Argentina de Consejos Profesionales de Ciencias Económicas (FACPCE) on March 19, 2009. For convenience purposes, it is presented in the format of a “Preliminary Draft” of an International Financial Reporting Standard (IFRS) on inflation accounting that could replace IAS 29 *Financial Reporting in Hyperinflationary Economies*.

Reasons for issuing the [Preliminary Draft] IFRS

IN2 The International Accounting Standards Board (IASB) undertook this project for these reasons:

(a) at present, IAS 29 applies only to the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy;

(b) financial statements may be materially affected by changing prices in economies that are inflationary but not “hyperinflationary”, as this term is characterized in IAS 29;

(c) currently, there is neither requirement nor encouragement to disclose the effect of (high) inflation before an economy becomes hyperinflationary and IAS 29 must be applied;

(d) it is difficult to justify a different accounting treatment when high inflation but not hyperinflation exists;

(e) Inflation restatements are already required in some countries where IFRSs are mandatory or are expected to be mandatory for some issuers of financial statements.

Main features of the [Preliminary Draft] IFRS

IN3 The main objective of this [Preliminary Draft] IFRS is to require that, when the inflation rate accumulated in certain periods reaches certain limits, comprehensive inflation restatements be performed.

Significant changes to previous IFRS

IN4 This [Preliminary Draft] IFRS:

(a) requires inflation restatements in environments where they are not mandatory according to IAS 29;

(b) explicitly specifies that inflation restatements are prohibited unless certain conditions are met.

Benefits and costs

IN5 The application of this [Preliminary Draft] IFRS will significantly enhance the usefulness of financial statements and increase the accounting costs of each issuer only by a small percentage of its annual total.

Effective date

IN6 An entity shall apply this [Preliminary Draft] IFRS for annual periods beginning on or after 1 January 201X. Earlier application is encouraged. An entity that applies this [Preliminary Draft] IFRS for a period beginning before 1 January 201X shall disclose this fact.

Invitation to comment

The IASB invites to make comments on all matters included in this [Preliminary Draft] IFRS, particularly on the questions set out below. Comments are most helpful if they:

(a) Refer to the questions as stated;

(b) Indicate the specific paragraph or paragraphs to which each comment relates;

(c) Contain a clear rationale;

(d) Include any alternative the Board should consider, if applicable.

Respondents should submit comments in writing for them to be received no later than [date to be determined by IASB]

Question 1) – [to be developed by IASB]

Question 2) – [to be developed by IASB]

Question …

[Preliminary Draft] International Financial Reporting Standard X *Inflation* ([Preliminary Draft] IFRS X) is set out in paragraphs 1-50. All the paragraphs have equal authority. Paragraphs in **bold type** state the main principles. Terms defined in Appendix A are *in italics* the first time they appear in the [Preliminary Draft] IFRS. Definitions of other terms are given in the Glossary for International Financial Reporting Standards. [Preliminary Draft] IFRS X should be read in the context of its Core Principle and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Framework for the Preparation and Presentation of Financial Statements*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

[PRELIMINARY DRAFT] INTERNATIONAL FINANCIAL REPORTING STANDARD X *INFLATION*

Core Principle

1 General level of prices may increase (inflation) or decrease (deflation). For convenience purposes, this [Preliminary Draft] IFRS refers to *inflation effects,* but the concepts included below are also applicable to *deflation* effects[2].

2 An entity shall recognize the effects of inflation of its *functional currency* on its financial statements, if and only if the conditions described in paragraph 5 are met.

Scope

3 **This [Preliminary Draft] IFRS shall be applied by all entities when preparing consolidated or separate financial statements for a financial year or an interim period.**

4 This [Preliminary Draft] IFRS does not deal with translations of measurements made in a functional currency to a different presentation currency. This issue is covered by IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Inflation restatements

5 An entity shall perform comprehensive inflation restatements when:

(a) The cumulative *inflation rate* of its functional currency for the last 12 months is equal or higher than 10%; or

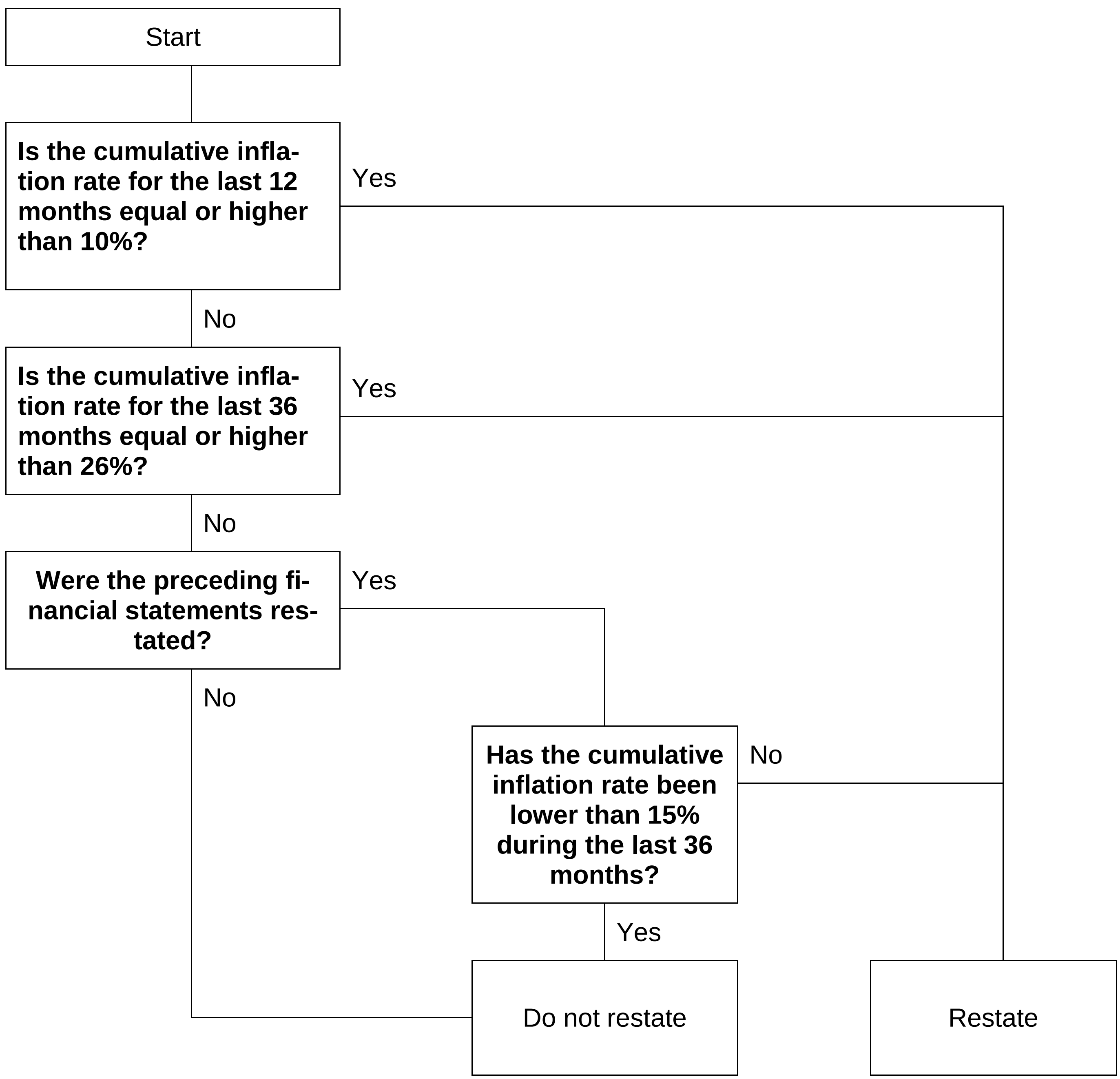
(b) The cumulative inflation rate of its functional currency for the last 36 months is equal or higher than 26%; or

(c) Its preceding financial statements were restated by applying this [Preliminary Draft] IFRS and paragraph 47 does not apply.

6 An entity shall not perform any inflation restatement when none of the conditions listed in paragraph 5 is met.

7 Therefore, the following decision tree should be considered:

[2] Generally, deflation effects are not material. If so, deflation adjustments may be omitted.


Start
Is the cumulative inflation rate for the last 12 months equal or higher than 10%?
Yes
No
Is the cumulative inflation rate for the last 36 months equal or higher than 26%?
Yes
No
Were the preceding financial statements restated?
Yes
No
Has the cumulative inflation rate been lower than 15% during the last 36 months?
No
Yes
Do not restate
Restate

Method

Main rule

8 **An accounting measure of an item in a set of financial statements shall be restated by using a coefficient obtained by dividing:**

(a) the *price index* corresponding to the date of the financial statements by

(b) the price index corresponding to the date of the purchasing power in which the measure is stated prior to the restatement process.

9 The date of the purchasing power in which a measure is stated prior to the restatement process may be the date of a transaction, the date of the last measurement or the date of a previous restatement for inflation (i.e. the date of the previous financial statements or, when the restatements are computed on a monthly basis, the end of the previous month).

10 For the purpose of applying paragraph 8, restatements can be performed and recorded each month (see [not yet developed] Appendix B), or they can be performed at the date of the financial statements. In this last case, transactions shall be generally grouped by month, and monthly price indexes shall be used. However:

(a) longer grouping periods may be used, provided that the resulting restated measurements are not materially affected;

(b) shorter grouping periods shall be used if restated measurements resulting from monthly grouping are materially affected.

When price indexes related to the grouping periods are not available, they shall be estimated by averaging, interpolation or extrapolation.

11 Before applying rule 8, financial statements of other entities used as basis for measurement when using the equity method or the proportionate consolidation method, shall be prepared according to this [Preliminary Draft] IFRS.

12 Restated accounting measures shall be treated by applying the corresponding IFRSs.

The price index

13 **The price index used to compute the inflation restatements required by this [Preliminary Draft] IFRS shall:**

(**a**) **be the same for all financial statements issued in a particular country;**

(**b**) **give a reliable representation of the changes in the purchasing power of the**

functional currency of the issuer of the financial statements;

(c) be prepared on the basis of a broad basket of goods and services;

(d) be prepared and issued on a regular basis by an entity with recognized independence and seriousness;

(e) be available when it is needed.

14 Inflation restatements should be made using the best price index available, whichever its denomination. Once selected, the same index should be used consistently while the conditions remain mainly unchanged. In some cases, a consumer price index shall be used. In some others, a wholesale price index will be more representative.

15 When the functional currency of the entity is the legal currency of two or more countries, the price index to be used shall represent a weighted average of the changes in the purchasing power of that currency in all those countries. If an average index is not available, the index to be used shall be the most representative of the inflation in the nation where the currency have been issued.

16 The Board suggests that the index to be used in each country or region be selected by each standard setter. When choosing the price index, special consideration should be given to the fact that some consumer price indexes are affected by governmental price controls.

Application of the main rule

17 ***Carrying amounts*** **measured in terms of the purchasing power of the functional currency at the closing date of the financial statements shall not be restated.**

18 The preceding rule applies usually to accounting measures of:

(a) cash and cash equivalents (including the closing balance shown in the statement of cash flows);

(b) assets or liabilities measured at their *fair value*s, their *fair values less costs to sell*, their *present values* or by applying the *effective interest method*;

(c) interests in other entities measured by using the equity method or the proportionate consolidation method, when applied on amounts stated in terms of the purchasing power of the functional currency at the closing date of the financial statements or the reporting entity;

(d) assets stated at their *recoverable amounts* calculated at the closing date.

19 Accounting measures stated in terms of the purchasing power of the functional currency at a previous date shall be restated by applying paragraph 8**.**

20 The preceding rule applies usually to accounting measures of:

(a) contributions from (or distributions to) owners;

(b) revenue;

(c) cost of assets;

(d) expenses;

(e) interests in other entities measured by using the equity method or the proportionate consolidation method, when applied on amounts stated in terms of the purchasing power of the functional currency at a date prior to the closing date of the financial statements or the reporting entity;

(f) comparative information in respect of previous periods;

(g) the opening balance of cash and cash equivalents shown in the statement of cash flows;

(h) increases and decreases of cash and cash equivalents shown in the statement of cash flows.

21 The purchasing power of a previous measure may correspond to the date of its recording or to a previous date. For example, the purchasing power of a (non-adjusted) charge to income for the depreciation of a machine is the purchasing power in which its cost is expressed, regardless of the period in which the depreciation is recognized as an expense.

22 When IFRSs are applied for the first time, the consequences of any partial inflation restatement included in any measurement must be eliminated before applying paragraph 8, unless such inflation restatement is a component of a deemed cost determined under IFRS 1.

23 When a previous inflation restated measurement is available, the corresponding adjusted figure at the date of the financial statements may be obtained by restating the previous accounting measure from the date of its previous restatement to the closing date of the financial statements. This is the standard procedure when adjusting comparative information in respect of previous periods.

24 Accounting measures resulting from the addition of two or more measures shall be restated as follows:

(a) each individual measure shall be restated by applying paragraph 8**;**

(b) a new addition shall be made using the restated measurements obtained in the previous step.

25 The preceding rule applies principally to accounting measures that accumulate amounts originated in several periods, such us:

(a) finished goods;

(b) construction in progress;

(c) property, plant and equipment;

(d) contributions from owners;

(e) income;

(f) expenses;

(g) cash flows.

26 When required, comparisons between carrying amounts and recoverable amounts of assets shall be made after restating carrying amounts in accordance with this [Preliminary Draft] IFRS.

27 Holding gains and losses shall be computed after restating carrying amounts in accordance with this [Preliminary Draft] IFRS.

28 Accounting measures resulting from the comparison of two or more measures shall be restated as follows:

(a) each measure compared shall be restated by applying paragraph 8**;**

(b) a new comparison shall be made using the restated measurements obtained in the previous step.

29 The preceding rule applies mainly to accounting measures of:

(a) interest earned;

(b) exchange differences;

(c) borrowing costs recognized as expenses or capitalized in accordance with IAS 23 *Borrowing Costs*;

(d) inflation losses on cash balances or other monetary assets or liabilities (that have a nil amount in the non-adjusted financial statements);

(e) impairment losses;

(f) reversals of impairment losses;

(g) gains or losses from the reclassification of assets to the class of non-current assets held for sale;

(h) gains or losses from the disposal of assets;

(i) other gains or losses recognized in comprehensive income.

30 In order to reflect financial revenues, exchange differences and borrowing costs in real terms, these items may be restated by applying paragraph 28. However, they can also

be restated by:

(a) applying paragraph 8 to the nominal amounts of financial revenues, exchange differences and borrowing costs;

(b) determining the inflation losses of gains attributable to the assets or liabilities that caused the financial revenues, the exchange differences or the borrowing costs;

(c) offsetting the figures calculated in (a) and (b).

31 Accordingly, borrowing costs capitalized under IAS 23 shall be net of inflation effects.

32 Some monetary assets or liabilities (i. e. cash and short-term employee benefits) do not cause nominal financial gains or losses. Therefore, their related inflation gains or losses must be calculated directly considering the effects of inflation on the balances of the said assets or liabilities.

Presentation and disclosure

33 **All items in a set of financial statements presented using the functional currency shall be stated in terms of the purchasing power of that currency at the end of the reporting period.**

34 The preceding rule applies to comparative information.

35 Disclosure of non-adjusted amounts of items in the financial statements is prohibited, unless required by a law or regulation. When such a requirement exists:

(a) the adjusted amount of an item shall be disaggregated between the amount required by the law or regulation and the difference with the restated amount; or

(b) the amount required by the law or regulation shall be reported using brackets.

36 Inflation gains and losses referred to in paragraph 32 shall be presented separately or, if not material, grouped with other items presented in the statement of comprehensive income or the separate income statement (if presented).

37 When an entity presents its financial statements using a currency other than its functional currency, the measures made in terms of the purchasing power of the functional currency shall be translated to the presentation currency by applying IAS 21.

38 An entity that applies the comprehensive method of inflation restatement shall disclose:

(a) this fact;

(b) when financial statements are presented using the functional currency, the fact that all their items were restated for the changes in the general purchas-

ing power of the functional currency and, as a result, are stated in terms of the purchasing power at the end of the reporting period;

(c) when financial statements are presented using another currency:

(1) the fact that all their items were restated for the changes in the general purchasing power of the functional currency; and

(2) an explanation of the rules applied to translate the resulting figures to the presentation currency;

(d) the identification of the price index used to compute the inflation restatements and its percent change along all the periods covered by the financial statements.

39 The disclosures required by this Standard shall make clear the basis of dealing with the effects of inflation in the financial statements. They are also intended to provide other information necessary to understand that basis and the resulting amounts.

Effective date and transition

40 An entity shall apply this [Preliminary Draft] IFRS to its annual or interim financial statements for periods beginning on or after 1 January 201X. Earlier application is permitted. If an entity applies this [Preliminary Draft] IFRS to its financial statements for a period before 1 January 201X, it shall disclose this fact.

First application of this [Preliminary Draft] IFRS

41 An entity shall perform comprehensive inflation restatements to the financial statements of an annual or interim period in which the conditions described in paragraph 5 are met, except as permitted by the next paragraph.

42 When preparing interim financial statements, an entity may depart from the requirement in paragraph 41, if the conditions described in paragraph 5 are met in the closing month and the timely completion of the restatements is *impracticable*. If so, the fact will be disclosed in the affected financial statements and the following financial statements of the entity shall be prepared according to this [Preliminary Draft] IFRS.

43 An entity shall apply this [Preliminary Draft] IFRS retrospectively in accordance with the requirements of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, except as permitted by paragraph 46.

44 As required by paragraph 10(f) of IAS 1 *Presentation of Financial Statements*, the first financial statements prepared by applying this [Preliminary Draft] IFRS shall include a statement of financial position as at the beginning of the earliest period for which it presents comparative information, which is the *date of transition to this [Preliminary*

Draft] IFRS.

45 When preparing the statement of financial position at the date of transition to this [Preliminary Draft] IFRS and the subsequent statements of financial position, an entity shall:

(a) remeasure deferred tax assets and liabilities recognized under IAS 12 *Income Taxes* by comparing (at the closing date of each period) the restated carrying amounts of assets and liabilities with their related taxable basis;

(b) assess if comparisons of the restated carrying amounts of assets with their recoverable values are needed and, if so, apply IAS 36.

46 When preparing the statement of financial position at the date of transition to this [Preliminary Draft] IFRS, an entity may:

(a) for inventories, use their replacement cost as their *deemed historical cost* restated at the date of transition for this [Preliminary Draft] IFRS, provided that the inflation restatement of the real historical costs is impracticable;

(b) for items in property, plant and equipment carried using the cost model, use their fair value as their deemed historical cost restated at the date of transition, provided that the inflation restatement of the real historical costs is impracticable;

(c) for investment property carried using the cost model, use their fair values as their deemed historical cost restated at the date of transition, provided that the inflation restatement of the real historical costs is impracticable;

(d) for cumulative translation differences recognized in other comprehensive income under IAS 21, assume that their restated amount is nil, provided that its recalculation is impracticable.

Ceasing and restarting of inflation restatements

47 An entity that performed comprehensive inflation restatements when preparing the financial statements of the preceding annual period shall discontinue the restatements if, at the beginning of the current annual period, the cumulative inflation rate of its functional currency has been lower than 15% during the last 36 months.

48 When inflation restatements are discontinued, the amounts expressed in the measuring unit prevailing at the end of the previous reporting period shall be used as the basis for the carrying amounts in its subsequent financial statements.

49 If, after the ceasing of inflation restatements, the conditions described in paragraph 5 are met again, the entity shall apply the rules in paragraphs 41-46.

Withdrawal of IAS 29 and IFRIC Interpretation 7

50 This [Preliminary Draft] IFRS supersedes IAS 29 *Financial Reporting in Hyperinflationary Economies* and IFRIC Interpretation 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies*.

Appendix A – Defined terms

This appendix is an integral part of the IFRS.

amortized cost	The amount at which a financial asset or a financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization using the **effective interest method** of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.
carrying amount	The amount at which an asset or a liability is measured in the accounting records.
date of transition to this [Preliminary Draft] IFRS	The beginning of the earliest period for which an entity presents full comparative information prepared using this [Preliminary Draft] IFRS.
deemed historical cost	An amount used as a surrogate for historical cost or depreciated historical cost at a given date.
effective interest method	A method of calculating the *amortized cost* of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.
fair value	The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.
fair value less costs to sell	The amount obtainable from the sale of an asset or cash-generating unit in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.
functional currency	The currency of the primary economic environment in which the entity operates, according to IAS 21.
impracticable	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

inflation rate	Percentage of increase in the figure of the chosen price index between two dates.
price index	A number that shows the variations in the prices of a set of products and services over time.
present value	A current estimate of the present discounted value of the future net cash flows in the normal course of business.
recoverable amount	The highest of an asset's (or cash-generating unit's) fair value less costs to sell and its **value in use**.
value in use	The present value of estimated future cash flows expected to arise from the continuing use of an asset and from its disposal at the end of its useful life.

[Not yet developed] Appendix B – Methods to perform restatements

[Not yet developed] Appendix C – Illustrative examples

Appendix D – Modifications to other IFRSs[3]

This appendix is an integral part of the IFRS.

D1 In IAS 1 *Presentation of Financial Statements*, paragraphs 51(d)-(e) are replaced by the following:

(d) the presentation currency, as defined in IAS 21;

(e) whether the financial statements reflect the inflation effects and, if so, the method used and the other disclosures required by [Preliminary Draft] IFRS X *Inflation*; and

(f) the level of rounding used in presenting amounts in the financial statements.

D2 In IAS 7 *Statement of Cash Flows,* the following paragraphs are added:

10A. When an entity performs the inflation restatements described in IFRS X *Inflation*, all the amounts presented in the face of the statement of cash flows or in the related notes shall be measured in terms of the purchasing power of the functional currency at the date of the financial statements.

19A. When an entity performs the inflation restatements described in IFRS X *Inflation*, and the statement of cash flows is presented using the direct method, the inflation gains and losses on cash and cash equivalents shall be disclosed separately and assigned to cash flows of operating activities.

D3 In IAS 23 *Borrowing Costs*, the second sentence of paragraph 9 is amended as follows:

When an entity performs the comprehensive inflation restatement described in IFRS X *Inflation*, the measure of borrowing costs shall be net of inflation.

D4 In the rest of the components of the IFRSs:

(a) references to IAS 29 *Financial Reporting in Hyperinflationary Economies* are

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[3] This appendix was prepared considering the IFRSs issued up to July 31, 2010.

changed to [Preliminary Draft] IFRS X *Inflation*;

(b) the word "hyperinflationary" is changed to "inflationary";

(c) the word "hyperinflation" is changed to "inflation".

Appendix E – Modifications to material accompanying other IFRSs[4]

E1 Paragraph 18 of appendix A to IAS 12 *Income Taxes* and the preceding title are amended as follows:

Inflation

18. Some assets and equity accounts are restated in terms of the purchasing power of the functional currency at the date of the financial statements (see IFRS X *Inflation*) for accounting purposes but not for tax purposes. (Note: The Standard requires an entity to account for the tax consequences of transactions and other events in the same way as it accounts for the transactions and other events themselves. Thus, for transactions and other events recognized in profit or loss, any related tax effects are also recognized in profit or loss. For transactions and other events recognized outside profit or loss, either in other comprehensive income or directly in equity, any related tax effects are also recognized outside profit or loss, either in other comprehensive income or directly in equity, respectively).

E2 In paragraph BC40 of the basis for conclusions of IAS 39 *Financial Instruments: Recognition and* Measurement, the phrase "(see IAS 29 *Financial Reporting in Hyperinflationary Economies*)" is deleted.

E3 In the rest of the material accompanying IFRSs:

(a) references to "IAS 29 *Financial Reporting in Hyperinflationary Economies*" are changed to "[Preliminary Draft] IFRS X *Inflation*";

(b) the word "hyperinflationary" is changed to "inflationary";

(c) the word "hyperinflation" is changed to "inflation".

Approval of this Research Report by the Special Commission

This Research Report was approved by 9 members of the Special Commission created by the Federación Argentina de Consejos Profesionales de Ciencias Económicas on March 19, 2009:

Fermín del Valle (chairman)

Fernando Casals

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[4] This appendix was prepared considering the IFRSs issued up to July 31, 2010.

Héctor Estruga

Jorge José Gil

Domingo Marchese

Hernán Pérez Raffo

Margarita Pérez Rodríguez

José Luis Pungitore

Carmen Verón

Mr. Santiago Lazzati left the Commission on December 31, 2009.

Mr. Enrique Fowler Newton agrees with the proposal to issue a new IFRS on inflation accounting, but dissents with some aspects of the Research Report. His alternative view is set out after the Basis for Conclusions.

Basis for Conclusions

Introduction

BC1 This Basis for Conclusions summarizes the Board's considerations in reaching the conclusions in respect of this [Preliminary Draft] IFRS X *Inflation*. Individual Board members gave greater weight to some factors than to others.

Reasons for issuing the [Preliminary Draft] IFRS

BC2 Accounting in inflationary economies is a challenging but still prevailing issue for the business community and the accounting profession in some parts of the world.

BC3 Years ago, the International Accounting Standards Committee (IASC) issued two standards dealing with the subject: IAS 15 *Information Reflecting the Effect of Changing Prices* and IAS 29 *Financial Reporting in Hyperinflationary Economies*. Furthermore, IAS 21 *The Effects of Changes in Foreign Exchange Rates* deals with translations of financial statements of entities in hyperinflationary economies.

BC4 IAS 15 was approved in June 1981. It encouraged particular disclosures of information reflecting the effects of changing prices but was not mandatory and was withdrawn by the International Accounting Standards Board (IASB) in 2003.

BC5 IAS 29 applies only to the financial statements of any entity whose functional currency is a currency of a hyperinflationary economy. According to IAS 29, hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following:

(a) the general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts held in local currency are immediately invested to maintain purchasing power;

(b) the general population considers monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;

(c) sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;

(d) interest rates, wages and prices are linked to a price index; and

(e) the cumulative inflation rate over three years is approaching, or exceeds, 100%.

BC6 Most issuers of financial statements omit the consideration of Indicators (a)-(d) set out in the preceding list because they are difficult to be monitored and because their presence is just a consequence of a high inflation rate.

BC7 An inflation rate of 100% over three years (the limit currently included in IAS 29) equals to 26% per year but much lower rates are sufficient to distort financial statements, if inflation effects are not properly recognized.

BC8 As IAS 29 does not preclude inflation restatements, comparability is affected. Inflation restatements:

(a) are required in some countries where IFRSs are mandatory or are expected to be mandatory[5];

(b) are omitted in other countries because the 100% limit is not reached, as if it were a barrier to be mandatorily overcome to make the restatements possible.

BC9 On the other hand:

(a) inflation is an external cause of equity variations which must be recognized by the accounting as well as any other external fact;

(b) it is difficult to justify the use of different accounting standards in inflationary and hyperinflationary environments.

BC10 Therefore, the IASB decided to reconsider its standards for the recognition of the effects of inflation.

[5] The Uruguayan Decree 99/2009 (http://www.presidencia.gub.uy/_web/decretos/2009/02/3282.pdf) requires the application of IAS 29 to certain entities, even if the context is not “hyperinflationary” according to IAS 29.

BC11 This [Preliminary Draft] IFRS does not deal with the choice of the currency to be used in the presentation of financial statements. This matter is treated in IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

Effects of the omission of inflation restatements

BC12 When no inflation restatements are made, comparisons and aggregations of amounts produce inadequate information.

BC13 Measurements affected by inadequate comparisons include, mainly, those of:

(a) impairments of assets (and their reversals), as they are measured by comparing carrying amounts measured at previous dates with recoverable amounts computed at the date of the financial statements;

(b) results from activities, as they are computed by comparing revenues and expenses measured in currencies at different moments;

(c) holding gains or losses, as they are computed by comparing measures determined at different dates;

(d) changes in cash and cash equivalents reported in the statement of cash flows, as they are measured by comparing cash and cash equivalents measured at the beginning and at the end of the reporting period.

BC14 Financial statements items affected by aggregations of measures not expressed in the same unit of measurement include, mainly:

(a) assets measured at cost or at depreciated cost, like inventories, items of property, plant and equipment, intangible assets, investment properties and goodwill;

(b) revenues and expenses of a period, including gains and losses other than those referred to in paragraph BC13;

(c) contributions from, and distributions to, owners;

(d) retained earnings;

(e) cash flows from operating, financing and investing activities.

How this [Preliminary Draft] IFRS improves financial reporting

BC15 This [Preliminary Draft] IFRS improves financial reporting by requiring that when any of the conditions described in paragraph 5 is met, all the components in a set of financial statements be expressed in the same unit of measurement, preventing the inadequate comparisons and aggregations referred to above.

How this [Preliminary Draft] IFRS improves transparency of markets

BC16 This [Preliminary Draft] IFRS improves transparency of markets because the release of adjusted financial statements precludes the retention of “inside information” by those charged with the governance of the reporting entity or by members of its management.

How this [Preliminary Draft] IFRS relates to the Conceptual Framework

Users and their information needs

BC17 Inflation adjusted financial statements serve better the needs of their users because they eliminate inadequate comparisons and aggregations of accounting data. Particularly, the inflation restatement enhances the information that enables investors to assess the ability of an enterprise to pay dividends and enables lenders to determine whether their loans and related interest will be paid when due.

Objective of financial statements

BC18 Inflation adjusted financial statements provide more useful information about financial position, performance and changes in financial position of the issuer.

Understandability

BC19 Users of financial statements are assumed to have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. Therefore, understandability of financial statements will not be affected by inflation restatements.

Relevance

BC20 Inflation adjusted financial statements are more relevant than non-adjusted statements for the decision-making needs of users. Some people do not consider inflation effects when making economic decisions but this does not validate the hypothetical conclusion that non-adjusted financial statements provide better information than those expressed in a homogeneous unit of measurement.

Reliability

BC21 Because of the elimination of inadequate comparisons and aggregations, inflation adjusted financial statements represent more faithfully what they purport to represent.

BC22 Inflation adjusted financial statements are more complete than non-adjusted financial statements because they recognize:

(a) gains or losses produced by the effects of the inflation on monetary items;

(b) impairment losses that remain concealed when financial statements are not adjusted.

Comparability

BC23 Inflation adjusted financial statements are more comparable than non-adjusted financial statements because their figures are expressed in a homogeneous unit of measurement.

Timeliness

BC24 Inflation restatements have a minimum impact on the time of completion of the preparation of financial statements.

Balance between Benefit and Cost

BC25 The application of this Standard will significantly enhance the utility of financial statements and will increase the accounting costs of issuers only by a little percentage of their total accounting costs.

BC26 After considering the results of this cost-benefit analysis, the IASB concluded that this Standard would sufficiently improve financial reporting to justify the costs it will impose.

When to adjust

BC27 As the only factor that needs to be corrected is the purchasing power of the currency, it is proposed that inflation rates be the only factor to be considered in order to determine whether inflation restatements shall be performed.

BC28 Given the methodological limitations of the published indexes in almost all countries, if low inflation rates exist, it is unlikely that the restatement of the figures will improve the information if it is compared against the information prepared using the nominal currency. The lowest the inflation rate is, the possible mistake to be generated as a consequence of a possible mistake in the calculation of the inflation rate is proportionally bigger. If the inflation levels are not significant enough, the restated financial statements do not necessarily provide better information than the ones that were not restated. Besides having a cost that can exceed the benefits, if the economic environment is below certain levels of inflation, the restatement can introduce a factor that could disturb the interpretation of the financial statements. As a result, it has been considered that a certain level of inflation rate must be reached in order to require the restatement.

BC29 The choice of the rates that trigger the performance of comprehensive inflation restatements has been a judgment call from the members of the Board, based on the understanding that the chosen levels of change in the purchasing power of the functional currency may lead the economic agents to consider in a different way the nominal variations of other variables and measure these variations in real terms instead of nominal terms.

Method

BC30 As the purpose of inflation adjustments is to reflect the effects of changes in the purchasing power of the functional currency, the main rule in paragraph 8 is based on the purchasing power in which the measures to be adjusted are stated.

BC31 The adopted is a comprehensive method of inflation restatements because all of the items in the financial statements are expressed in the same unit of measurement.

BC32 When developing the main rule in paragraph 8 and its application, the Board considered that:

(a) The purpose of inflation restatements is to adjust accounting measures;

(b) The purchasing power in which each non-restated accounting measure is expressed depends on the attribute used in the measurement process;

(c) The use of some attributes (i. e. fair value) results in carrying amounts measured in terms of the purchasing power of the functional currency at the closing date of the financial statements;

(d) The use of other attributes (i. e. cost and depreciated cost) results in carrying amounts measured in terms of the purchasing power of the functional currency at an earlier date;

(e) Some accounting measures result from adding or comparing other accounting measures.

BC33 The Board analyzed the view that items should be classified into “monetary” and “non-monetary” and that “non-monetary” items should be adjusted. This approach was developed some decades ago, when almost all non-monetary items were measured on the basis of their historical costs or depreciated costs. Under current IFRSs, an entity may have non-monetary items measured at their fair value, at their net realizable value or at sales price less costs to sell, which are stated in the purchasing power of the date of the financial statements. Thus, the adoption of the monetary/non-monetary approach should require exceptions that would lead to this classification of items:

(a) Monetary items;

(b) Non-monetary items expressed in terms of the purchasing power of the functional currency at the closing date of the financial statements;

(c) Other non-monetary items.

BC34 In addition, the “other non-monetary items” would include items of various kinds:

(a) Those expressed in a defined purchasing power, like the cost of a purchased raw material;

(b) Those resulting from adding items included in category (a) corresponding to more than one period, like the cost of manufactured goods;

(c) Those resulting from comparing accounting measures expressed in more than one purchasing power, like a holding gain or an impairment loss.

BC35 Because of the foregoing, the Board considered that the classification of items into “monetary” and “non-monetary” is not helpful for the purpose of developing the rules for inflation restatements. However, the fact that monetary items cause inflation gains or losses was considered in paragraphs 30-32.

BC36 It shall be emphasized that the application of this [Preliminary Draft] IFRS will lead to the same results as the application of the monetary/non-monetary approach, provided that the latter adequately considers the fact that there are different kinds of non-monetary items (see paragraph BC34).

The price index

BC37 The Board has considered that restatements for inflation should be made using the best price index available, whichever its denomination. Therefore, paragraph 13 states the conditions that a price index shall meet to be used for accounting purposes.

BC38 The fact that a consumer price index is preferable in a certain country does not validate the conclusion that a consumer price index shall be preferable in another country.

BC39 Inflation restatements are made to reflect the inflation of a currency rather than the inflation in a specific country. Therefore, it is required that when the functional currency of the entity is used in two or more countries, the price index to be used shall represent a weighted average of the changes in the purchasing power of that currency in all those countries.

Ceasing of the comprehensive inflation restatements

BC40 The 15% cumulative rate used in paragraph 47 as a trigger to determine if restatements must be discontinued is also a consequence of the criteria of the Board based on experience. The implicit concept in this rule is that once in an economic environment, the use of restated amounts of currency and the measurements in real terms of economic variables are more relevant than the equivalent measurements in nominal terms. The fact that the inflation process has disappeared or decreased in a significant way needs to be proved in order to allow the return to the use of the nominal currency.

Presentation and disclosure

BC41 The rules about presentation and disclosure in [Preliminary Draft] IFRS X are consistent with the qualitative characteristics of financial information in IAS 1.

BC42 The disclosures required in [Preliminary Draft] IFRS X are needed to make clear the basis of dealing with the effects of inflation in the financial statements. They are also intended to provide any other information necessary to understand such basis and the resulting figures.

Alternative View of Mr. Enrique Fowler Newton

AV1 Mr. Enrique Fowler Newton agrees with the proposal to issue of an IFRS that requires inflation restatements, but disagrees with any rule (other than the one that permits not to apply an accounting rule when its effects are not material) that permits an entity not to recognize inflation effects in its financial statements in a comprehensive way. In his view:

(a) when material inflation effects are not recognized or are incompletely recognized, the resulting financial information is not comparable, not completely relevant and, as a consequence, not completely useful;

(b) the cost of computing inflation restatements is not important, when compared with the total costs required by the accounting system;

(c) the main tasks required by inflation restatements may be computerized;

(d) comprehensive inflation restatements have been performed in Argentina, México, Uruguay and other countries for years without major problems;

(e) eventually, simplifications may be made in the context of the comprehensive method, provided that they do not distort significantly the financial statements.

AV2 Therefore, Mr. Fowler Newton objects that comprehensive inflation restatements:

(a) are not generally required;

(b) are explicitly prohibited by paragraph 6 of this [Preliminary Draft] IFRS when the conditions specified in paragraph 5 are not met.

AV3 It must be noted that:

(a) the prohibition in paragraph 6 is not present in IAS 29 and may be easily encircled by applying paragraph 19 of IAS 1 when non-adjusted financial statements are so misleading that they would conflict with the objective of financial statements set out in the Conceptual Framework adopted by the IASB;

(b) although an IFRS requires comprehensive inflation restatements, these can be omitted if the effects of the omission are not material.

Summary of main proposals of accounting standard setters not incorporated in this [Preliminary Draft] IFRS

Colegio de Contadores de Chile

Proposal	*Comments of the Commission*
1. IAS 29 shall be maintained for hyperinflationary currencies.	See paragraphs BC5-BC10.
2. When inflation exists but IAS 29 does not apply, an inflation restatement approach may be used. Alternatively, it may be considered that the use of fair values implies a permanent monetary correction mechanism.	See paragraphs BC5-BC10. In addition, it must be noted that the use of fair values without inflation restatements leads to inadequate measurements of current and accumulated profits and losses. Holding gains and losses shall be computed after restating carrying amounts.
3. SMEs shall have the possibility of performing inflation restatements.	In the Commission's opinion, the IFRS for SMEs regarding inflation should be in line with this [Preliminary Draft] IFRS.

Comité de Pronunciamentos Contábeis do Brasil (CPC)

Proposal	*Comments of the Commission*
1. The proposal is based on rules rather than on principles because requirements to start or cease inflation restatements are based on fixed percentages of inflation rates.	The experience with the application of IAS 29 has demonstrated that the qualitative factor prevails when determining if inflation restatements are necessary.
2. There should be simplified methods to be applied when inflation rates are lower.	
3. Adjustments to current values might be extensively accepted when comprehensive inflation restatements are required.	The Commission thinks that inflation restatements should deal only with the unit of measurement issue. Restated accounting measures shall be treated by applying the corresponding IFRSs.
4. Rules about price indexes could be more precise. The use of wholesale price indexes	See paragraphs BC37-BC38.

is not allowed by SEC and UN.

Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera (CINIF)

Proposal	*Comments of the Commission*
1. Requirements to start or cease inflation restatements are based on fixed percentages of inflation rates. CINIF disagrees because the IFRS shall be based on principles rather than on rules. It is preferable to require restatements when the context is "inflationary" and to prohibit them when the context is "not inflationary". Both terms should be defined in the [Preliminary Draft] IFRS.	The experience with the application of IAS 29 has demonstrated that the quantitative factor prevails when determining if inflation restatements are necessary. The inflation levels proposed as "triggers" (10% in the last 12 months or 26% in the last 36 months) are considered objective guidelines to evaluate if a context is inflationary. In the Commission's view, it is preferable to establish these objective guidelines than to permit that each standard setter defines when a context is inflationary.
2. The "trigger" to start restatements should be the tendency of the inflation rather than the accumulated inflation rate.	
3. Inflation restatements should always start in annual financial statements.	
4. Deflation effects should not be recognized.	Deflation effects should be recognized for the same reasons as inflation effects. However, they may be omitted when not material.
5. Adopt the *monetary/non-monetary approach*.	See paragraphs BC30-BC36