



# Inflation effects accounting recognition



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# Proposal of a new IFRS in order to recognise high inflation effects on financial statements

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## 1. New IFRS Objective

To require the recognition of inflation effects on entities financial statements, when they operate in an inflationary environment, and don't to expect until the existence of a hyperinflationary environment, as required by IAS 29.

### *Inflationary environment:*

- Exists when the recorded accumulated inflation for the last 3 years is 26% or more
- Being close to 26%, short term expectations indicate that high inflation won't be controlled



## **2. Inflationary environment indicators**

**The 26% parameter was determined considering the following:**

- **Effects of an annual inflation rate of 8% or higher, not properly recognised in the financial statements, distorts significantly the financial information**
- **The maintenance for prolonged periods of an annual rate of at least 8% indicates that inflation is out of control (8% annual in 3 years = 26% accumulated)**



## 2. Inflationary environment indicators (cont)

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*We are aware that there are others indicators of the existence of an inflationary economy, nevertheless, our proposal is to give an important weight to the inflation index, that is the final effect of the environment and the one who affect the financial statements information*



## **2. Inflationary environment indicators (cont)**

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*... We know that all the parameters are arbitrary, nevertheless:*

*Our proposal is based in our experience for have been living and working during very prolonged periods in inflationary environments, having prepared and analysed financial information, both with and without inflation effects restatement*

*We considered highly inadequate to require restatement only when hyperinflation exists, as required by IAS 29, because very common distortive situations are ignored*



### **3. Reasons for issuing a new IFRS**

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***Requiring the recognition of inflation effects, the new IFRS will help avoiding the following problems in the entity financial statements:***

- ***Underestimation of assets measured at historical cost and their effect on profit or loss for depreciation, amortization or impairment***
- ***Distortion in the relationship between income and expense when both are measured in currencies with different purchasing power***
- .....>



### 3. Reasons for issuing a new IFRS

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- .....>
- **Existence of unrecognized income and expense for the effect of inflation on monetary items**
- **Underestimation of capital contributions and other contributions of entity's owners**
- **It is difficult to identify the amount corresponding to capital maintenance, and therefore is unknown the real increase of equity, having no base for a proper distribution of dividends ore other forms of net income**





## 4. Restatement method

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### *Effects determination*

**Our proposal is that inflation effects have to be determined using the “Integral Method”, which requires the quantification of the effects on all the items of the financial structure of the entity, as follows:**

- To restate non monetary items: Inventories, Property, Plant & Equipment; Intangible assets; Equity, etc.**
- To recognize in profit or loss gains and losses caused by the effect of inflation on monetary items**



## 4. Restatement method

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### *Effects recognition*

**Our proposal is to recognize the inflation effects in the primary entity's financial statements**

***In our opinion only to disclose the inflation effects in financial statements notes will be insufficient, when we know that the entity's financial structure has been significantly modified because of those effects***



## 5. Alternative solutions used

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### *Use of Fair value measurements*

**To value assets and liabilities using fair value or reposition costs with changes recognized in Equity**

***We consider that this alternative is not adequate, because of Equity components being substantially distorted, recognizing the effect of the value changes but not identifying the increase or reduce in real terms***

***Additionally, the effect of inflation on monetary items won't be measured and recognized***



## 5. Alternative solutions used

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*Just to disclose the restated information (not recognition)*

**Countries having high and medium levels of inflation used briefly this alternative, but the experience wasn't satisfactory**

*In those countries, the requirement was discontinued because of the confusing information provided to users of financial statements*



## 5. Alternative solutions used

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### *Same purchasing power currency accounting*

- **To measure all the items in the financial statements using a currency with the same purchasing power, being the one at closing date**
- **Hyperinflationary countries have been using this restatement method with very satisfactory results**

*Nevertheless, for cost-benefit reasons, the method only have to be used to avoid significant distortions in financial information analysis*



## 6. Conclusions

Based in our experience and research, our conclusions are the following:

- *Accumulated inflation indexes for three previous annual periods of 26% or more produce significant distortions in the entity financial structure, and therefore our proposal is that the effects have to be recognised in the entities financial statements*
- *To just recognize the hyperinflation effects is not proper because leave unrecognised very important distortions*
- *Our proposal to the IASB is to create a working group to research about the inflation effects recognition, based in the situation of many countries having inflationary environments*



Thank you  
very much!!

