EMERGING ECONOMIES GROUP 2019 MEETING - ARGENTINA

APPLICATION OF IAS 29 IN ARGENTINA FOR 2018 HYPERINFLATION

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- **Introduction**

During 2018, it was defined that the currency of Argentina (the Argentine peso) is hyperinflationary in the terms of IAS 29.

There was a general agreement among different stakeholders on applying the IAS 29 by preparing financial statement of any entity whose functional currency is the Argentine peso for annual or intermediate period ended on or after July 1st, 2018.

As a result of this definition, entities into the scope of the definition need to present comparative information also restated using IAS 29, since the “transition date” according to this standard and the IFRIC 7, ie annual years ending on or after July 1st, 2016.

Even in the past Argentine entities has applied a restatement procedure of financial statements in local GAAPs, no general experience on applying IAS 29 existed among Argentine preparers.

The consequence of the prolonged period without using high inflation restatement standards was a lack of experience on applying standards similar to IAS 29, the Argentine high inflation restatement standard, with the additional difficult emerging from a lot of changes made, during the past years, in accounting standards, both IFRS and Argentine GAAP, not considered obviously in IAS 29 directly or even in many cases indirectly.

The FACPCE developed, together with regulators, a jointly work to agree most of the proposals for the treatment of unclear issues. The product of the mentioned work was a guide for the application of the IAS 29 and Argentine Standard suggesting, when the issue isn’t considered in the standards, which is considered the best technical option or, in certain cases, accepted alternative treatments mainly for simplicity reasons.

It is important to remark that this guidance is not an authorized interpretation of the IAS 29, and the parts involved in its development take care for not assuming an interpretative role, but an orientate role.

- **Accounting issues not included in the IAS 29**

Most of the significant changes in accounting standards since 1990 to the present are not included in the IAS 29, because this standard was not applied during the mentioned period in significant countries using IFRS Standards.

The only issue analyzed during that period by the IFRIC was in regards with the general concept in the IAS 29 to be applied for deferred tax assets and liabilities. The emerging doubt was how to consider those tax assets and liabilities respect with its classification as “monetary” or “non-monetary”.

In this opportunity, the IFRIC 7 stated the concept of items calculated by comparison of two different amounts in considering the measurement of deferred tax items but doesn’t developed the general reasoning about its application to other gains or losses.

Amounts included in the financial statements calculated comparing two different amounts are very common in the statement of profit or loss and other comprehensive income of the period, and therefore for the last the accumulated amounts in the equity.

A common example of the mentioned amounts is income or expense for fair value measurements of assets calculated comparing the previous amounts of the asset with the new amount. In hyperinflationary environments those figures are expressed in different purchasing power values and therefore they have to be re-calculated, restating previously each amount to the purchasing power value of the reporting date.

The following is an example of the application of the mentioned issue in restating the net income for sales of PP&E:

Net income for sales of PP&E				
Concepts	**$**	**Date**	**Coefficient**	**$c**
Selling Price	1.000	September 2018	1,35	1.350
Derecognition of PP&E	(250)	May 2005	5,45	(1.363)
Net Income (Expense)	750			(13)

Clearly, the amount of the nominal difference cannot be attributed to a certain date because it is the difference between figures expressed in purchasing power of the functional currency from different dates. The date of accounting record in the books cannot be considered as a date of measurement of the nominal amount calculated. As it was previously stated, the only way is previously restating the figures and then, re-calculate the difference.

Under the mentioned situation positives nominal amounts can be converted in negative restated amounts and vice versa.

Regarding to the issue, in the IAS 29 there is only a reference to “revaluation surplus” at the beginning of the first period of application of the standard. In our view, the solution required by the IAS 29 is related to the simplification of the calculation and not an answer to technical sophisticated requirements.

Another issue not contemplated by IFRS Standards is the presentation of comparative information measured using a non-hyperinflationary functional currency but with a reporting hyperinflationary currency. (eg, functional currency: US$, reporting currency AR$)

The IAS 21 stated of the treatment for comparative information translated to a non-hyperinflationary currency, but it is silent about the case of translation to a hyperinflationary reporting currency.

In the IAS 29.34. it is stated:

> *Corresponding figures for the previous reporting period, whether they were based on a historical cost approach or a current cost approach, are restated by applying a general price index so that the comparative financial statements are presented in terms of the measuring unit current at the end of the reporting period.*

In our view, to comply with paragraph 34 of the IAS 29 to the technical way would be to restate the previous amounts reported in a hyperinflationary currency to the end of the reporting period, recognizing the arising difference in OCI as a “translation adjustment”. However, we are aware that this issue is being treated in different ways in practice, and there would not seem to be an only way for reading this requirements not specifically treated in the IAS 21.

In our view, it is necessary to include this issue in a future revision of the IAS 21 or the IAS 29 to avoid the lack of understandings in practice about how to treat the mentioned situation.

- **Starting point - Challenges**

On applying the IAS 29 to the “transition date” many difficulties appeared, especially regarding to the cumulative amounts of some equity items.

In measuring assets and liabilities, general rules apply and, with the inclusion of tax assets and liabilities in the text of the IFRIC 7, we have a good base for the restatement of almost all the items, and therefore the calculation of the aggregated amount of net assets, but it is not the same respect to the individual amounts of equity components.

It would be appropriate to classify the difficulties in three different groups:

- Equity transactions dates when a differed payment occur
- Legal and regulatory reserves
- Cumulative amount of OCI items

Equity transactions dates when a differed payment occur

In our legal environment the nominal amount of shares capital is required to be presented in financial statements, and for hyperinflationary situations we have to recognize an additional item called “Shares capital adjustment”.

The difficult arise when the transaction includes differed payment. Our legal requirements allow to complete the payments till two years after the issue of the shares, in most of the cases without financial charges for the delayed payment.

The options analyzed included:

- To recognize a loss for inflation effect over the monetary amount of the credit with owners during the period between recognition and payment.
- To measure the amount at its fair value when, the entity becomes party to the contractual provisions of the instrument.
- To recognize the amount of capital when the payment occurs, that is not to recognize the credit against owners between

We found different concepts about the issue in the IFRS Standards and the IFRS for SMEs Standard.

Regarding to this topic, the IAS 29 includes the following text:

"At the beginning of the first period of application of this Standard, the components of owners' equity, except retained earnings and any revaluation surplus, are restated by applying a general price index from the dates the components were contributed or otherwise arose.

In the views of many interested parties the "otherwise arose" concept allows to consider share capital when the entity is part of the contract (issuing date).

Legal and regulatory reserves

This issue seems to be more a regulatory issue than an accounting issue, but was needed to be considered when preparing the guide.

Almost all the legal and regulatory reserves are nominal amounts with no consideration in the regulation about potential restatement in case of hyperinflation.

If the nominal amount have to be considered as the amount to reserve, the option is to use the nominal amount at the "transition date" and as retained earnings are calculated as the difference between the total amount of equity previously determined and the rest of the restated amounts of equity items, translation to retained earnings of the inflation effect is a consequence of the applied method.

After the "transition date" all the equity items have to be restated and therefore if the nominal amount has to be maintained, a transference between the item and retained earnings is needed to be recorded.

Cumulative amount of OCI items

Regarding to the equity items of cumulative OCI, the IAS 29 includes the following text:

"Any revaluation surplus that arose in previous periods is eliminated. Restated retained earnings are derived from all the other amounts in the restated statement of financial position."

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Even if we know that many of the OCI items weren't contemplated when the IAS 29 was issued, the application of the general rule means that, except for the revaluation surplus (in the IAS 16 and the IAS 38) others cumulative OCI items have to be presented restated in equity at the transition date.

In our view, the only appropriate technical solution for others cumulative OCI items at the transition date is to restate them using by analogy the methodology included in IFRIC 7 for deferred tax assets and liabilities, that is to obtain the restated amounts of OCI of each period restating all the components of the calculation in currency of the date of the end of the reporting period and remaking the calculation. Then, to determinate the cumulative amount at the transition date as the cumulative amounts of the figures of each period, previously restated to the date of the end of the reporting period.

In case of an accounting policy of the entity to immediate transfer to retained earnings the whole of the equity component of OCI (eg, IAS 19) the cumulative amount in equity at the transition date will be nil.

The following are examples of our preferred method for restatement of items of OCI, as said using by analogy the restatement method for deferred tax assets and liabilities defined by the IFRIC 7,that is to calculate the restated amounts of differences recalculating it after restating the original amounts of the calculation components:

Changes in revaluation surplus					
ASSET					
DATE	Concepts	AR $	Index	AR $c 17	AR $c 18
31/12/16	Initial amount of PP&E (Residual Cost $ 80.000.-)	120.000	100,000	189.600	240.000
30/04/17	Period acquisitions of PP&E	20.000	120,000	26.333	33.333
31/12/17	Period depreciation over Initial amount	(12.000)	158,000	(18.960)	(24.000)
31/12/17	Period depreciation over Period acquisitions	(1.333)	158,000	(1.756)	(2.222)
31/12/17	Transfers to Retained Earnings				0
31/12/17	Revaluation adjustments	123.333		54.782	69.345
31/12/17	Final amount PP&E	250.000	158,000	250.000	316.456
30/04/18	Period acquisitions of PP&E	30.000	175,000		34.286
31/12/18	Period depreciation over Initial amount	(25.000)	200,000		(31.646)
31/12/18	Period depreciation over Period acquisitions	(2.000)	200,000		(2.286)
31/12/18	Transfers to Retained Earnings				
31/12/18	Revaluation adjustments	97.000			33.190
31/12/18	Final amount PP&E	350.000	200,000		350.000

Changes in revaluation surplus								
PROFIT OR LOSS			RETAINED EARNINGS			OCI: REVALUATION SURPLUS		
AR $	AR $c 17	AR $c 18	AR $	AR $c 17	AR $c 18	AR $	AR $c 17	AR $c 18
						(40.000)	0	0
12.000	18.960	24.000						
1.333	1.756	2.222						
			(4.000)	0	0	4.000	0	0
						(123.333)	(54.782)	(69.345)
13.333	20.716	26.222	(4.000)	0	0	(159.333)	(54.782)	(69.345)
25.000		31.646						
2.000		2.286						
			(15.364)		(6.709)	15.364		6.709
						(97.000)		(33.190)
27.000		33.931	(15.364)		(6.709)	(240.969)		(95.826)

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Defined Benefits Plans					
LIABILITY					
Fecha	**Conceptos**	**AR $**	**Index**	**AR $c 17**	**AR $c 18**
31/12/16	Liability initial amount	(180.000)	100,000	(284.400)	(360.000)
30/04/17	Pensions payments	12.500	120,000	16.458	20.833
31/12/17	Accrued benefits	(45.000)	158,000	(45.000)	(56.962)
31/12/17	Discount reversal	(10.800)	158,000	0	0
31/12/17	New measurements	(12.500)	158,000	77.142	97.648
31/12/17	Transfers to Retained Earnings		158,000		
31/12/17	Liability final amount	(235.800)	158,000	(235.800)	(298.481)
30/04/18	Pensions payments	14.000	175,000		16.000
31/12/18	Accrued benefits	(52.000)	200,000		(52.000)
31/12/18	Discount reversal	(14.148)	200,000		0
31/12/18	New measurements	(42.052)	200,000		4.481
31/12/18	Transfers to Retained Earnings		200,000		
31/12/18	Liability final amount	(330.000)	200,000		(330.000)

Defined Benefits Plans								
PROFIT OR LOSS			**RETAINED EARNINGS**			**OCI: REMESUREMENTS**		
AR $	**AR $c 17**	**AR $c 18**	**AR $**	**AR $c 17**	**AR $c 18**	**AR $**	**AR $c 17**	**AR $c 18**
						0	0	0
45.000	45.000	56.962						
10.800	0	0						
						12.500	(77.142)	(97.648)
			12.500	(77.142)	(97.648)	(12.500)	77.142	97.648
55.800	45.000	56.962	12.500	(77.142)	(97.648)	0	0	0
52.000		52.000						
14.148		0						
						42.052		(4.481)
			42.052		(4.481)	(42.052)		4.481
66.148		52.000	42.052		(4.481)	0		0

P or L for Equity Investments at FV with changes in OCI					
ASSET					
Fecha	**Conceptos**	**AR $**	**Index**	**AR $c 17**	**AR $c 18**
30/09/16	Investment Acquisition	200.000	90,000	351.111	
31/12/16	Fair Value adjustment	30.000	100,000	12.289	15.556
31/12/16	Final amount Investment	230.000	100,000	363.400	460.000
30/04/17	Dividend received ($ 35.000.-)		120,000		
31/12/17	Fair Value adjustment	95.000	158,000	(38.400)	(48.608)
31/12/17	Final amount Investment	325.000	158,000	325.000	411.392
30/04/18	Dividend received ($ 40.000.-)		175,000		
31/12/18	Fair Value adjustment	102.000	200,000		15.608
31/12/18	Final amount Investment	427.000	200,000		427.000

P or L for Equity Investments at FV with changes in OCI					
PROFIT OR LOSS			OCI: CHANGES IN FV EQUITY INSTRUMENTS		
AR $	AR $c 17	AR $c 18	AR $	AR $c 17	AR $c 18
			(30.000)	(12.289)	(15.556)
(35.000)	(46.083)	(58.333)			
			(95.000)	38.400	48.608
(35.000)	(46.083)	(58.333)	(125.000)	26.111	33.052
(40.000)		(45.714)			
			(102.000)		(15.608)
(40.000)		(45.714)	(227.000)		17.444

- **Equity transactions: “contributed or otherwise arose”**

Other issue arises from share capital transactions with owners after the transition date when payment is deferred.

As previously said, IAS 29 pa. 24 states: “*At the beginning of the first period of application of this Standard, the components of owners’ equity, except retained earnings and any revaluation surplus, are restated by applying a general price index from the dates the components were contributed or otherwise arose.*

On the other hand, IAS 29 pa. 25 states: *“At the end of the first period and in subsequent periods, all components of owners’ equity are restated by applying a general price index from the beginning of the period or the date of contribution, if later.”*

Does the IAS 29 create a difference between transactions before the initial date of application and after it (the otherwise arose issue)?

We don’t have a clear answer for the question. A logic reasoning can be that in pa. 25 it is the issue mentioned in general terms, not excluding the “otherwise arose” option. It is difficult to think about a reason for different treatments of the same issue at different dates. Clearly it isn’t a simplification issue to facilitate the application of the standard.

- **Pa. 16 exception applicable by analogy?**

The following is the text of pa. 16 of IAS 29, clearly an exception to facilitate the transition from nominal amounts to restated amounts in a hyperinflationary currency environment:

“Detailed records of the acquisition dates of items of property, plant and equipment may not be available or capable of estimation. In these rare circumstances, it may be necessary, in the first period of application of this Standard, to use an independent professional assessment of the value of the items as the basis for their restatement.”

One emerging question is if, in the same situation, can the professional assessment be used for the initial measurement of Investment Property or Intangible Assets.

In case of an affirmative answer, other questions arise:

- For Intangible Assets is required the existence of an Active Market to accept the restated amount?
- If an Active Market exists, is necessary the participation of an independent professional?

In our view is necessary to have answers to those questions in a future revision of the IAS 29.

- **Gain or loss on the net monetary position: Presentation and disclosure**

In relationship with presentation issues, pa. 28 of IAS 29 states:

"*The gain or loss on the net monetary position is included in profit or loss. The adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 13 is offset against the gain or loss on net monetary position.*"

There are different views about how this paragraph has to be interpreted.

- The FACPCE view, to be included in the guide, is to present the income or expense created by prices adjustments mechanisms as part of the gain or loss on net monetary position, offsetting the inflation effect over those assets and liabilities.
- Other view is that the proper presentation of the gain or loss on monetary assets and liabilities is offsetting the one produced by each one of the monetary assets and liabilities with the financial income or expense arising from it, disclosing in the notes the gross amount of financial income an expense and its corresponding gain or loss for inflation effect. (i.e. offset the interest cost of loans with the inflation effect on its amount for the period)
- We think that is very important to include this issue in future revision of IAS 29.

The rest of pa. 28 of IAS 29 states:

"Other income and expense items, such as interest income and expense, and foreign exchange differences related to invested or borrowed funds, are also associated with the net monetary position. Although such items are separately disclosed, it may be helpful if they are presented together with the gain or loss on net monetary position in the statement of comprehensive income."

Because of the previous paragraph arises another question:

Could the amount of gain or loss on the net monetary position be presented or disclosed in an alternative way?

Is correct to present it as a net amount and only disclose it together in the notes?

Pa. 28 only says: "can be helpful" but doesn't require it.