STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	**Translating a Hyperinflationary Foreign Operation (IAS 21 and IAS 29)**
Paper topic	Initial consideration—Presenting Exchange Differences when a Foreign Operation is Hyperinflationary

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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about the application of IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*. The submitter asks how a reporting entity—with a non-hyperinflationary presentation currency—presents any differences that arise on restating and translating the results and financial position of a hyperinflationary foreign operation.

2. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

3. This paper includes:

   (a) background information (paragraphs 4–21);

   (b) outreach and additional research performed (paragraphs 22–28);

   (c) staff analysis (paragraphs 29–64); and

   (d) staff recommendation (paragraphs 65–66).

Background information

The matter

4. In the fact pattern described in the submission, a reporting entity (Entity P):

   (a) prepares consolidated financial statements, and presents those financial statements in a non-hyperinflationary presentation currency; and

   (b) has a hyperinflationary foreign operation (Entity S).

5. In preparing its consolidated financial statements, Entity P translates Entity S's results and financial position into its presentation currency. To do so, Entity P applies the restate/translate approach required by IAS 29 and IAS 21 (see paragraph 19 of Agenda Paper 4 for this meeting). Applying this approach, Entity P:

   (a) first restates Entity S's financial statements applying IAS 29[1]. That IAS 29 restatement results in a change to Entity S's equity and, consequently, a change to Entity P's net investment in Entity S (restatement effect). This restatement reflects the effects of hyperinflation; and

[1] Paragraphs 20–24 of Agenda Paper 4 provide an overview of the applicable requirements in IAS 29.

(b) then translates those financial statements into its presentation currency applying paragraph 42 of IAS 21[2]. In particular, Entity P translates all items in the financial statements of Entity S at the closing rate. This translation results in a translation effect that reflects changes in the exchange rates[3].

6. The simplified example in paragraphs 8–18 of this paper illustrates the fact pattern.

7. The submitter asks how Entity P presents the restatement effect and translation effect in its consolidated financial statements.

Simplified example

8. Assume Entity P has a reporting date of 31 December and uses GBP as its presentation currency. Entity P owns all the ordinary shares of, and controls, Entity S (foreign operation).

9. Entity S:

   (a) has a functional currency of Local Currency (LC);

   (b) was set up on 1 January 2017 through an investment of GBP400 by Entity P—the exchange rate on that date is LC1: GBP0.40, which results in an investment of LC1,000 in Entity S;

   (c) used the proceeds of this investment to buy a non-depreciable non-monetary asset for LC1,000; and

   (d) did not generate any revenue or incur any expenses in 2017.

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[2] Paragraph 28 of Agenda Paper 4 reproduces paragraphs 42–43 of IAS 21.

[3] For ease of reference, this paper uses ‘restatement effect’ and ‘translation effect’ when referring to what the submission describes as ‘hyperinflationary effect’ and ‘foreign currency translation effect’.

10. The economy within which Entity S operates is hyperinflationary in 2017. The Consumer Price Index of this hyperinflationary economy is as follows:

    (a) 1 January 2017: 100

    (b) 31 December 2017: 300 (ie the inflation rate over 2017 is 200%).

11. The exchange rate between the two currencies at 31 December 2017 is LC1: GBP0.25 (closing rate).

Statement of financial position at 1 January 2017

12. Entity P consolidates Entity S's results and financial position as follows:

    (a) Step 1: applying IAS 29, Entity P restates Entity S's non-monetary asset and share capital to reflect inflation at 1 January 2017. Because the date on which Entity S is set up is also Entity P's reporting date, there is no adjustment to the non-monetary asset and share capital. Accordingly, Entity S's restated non-monetary asset and share capital are LC1,000.

    (b) Step 2: applying paragraph 42 of IAS 21, Entity P translates Entity S's non-monetary asset and share capital at the exchange rate at 1 January 2017. The translated amounts of Entity S's non-monetary asset and share capital are GBP400 (LC1,000 × 0.40 = GBP400).

    (c) Step 3: Entity P combines items in its financial statements with those of Entity S, and offsets the carrying amount of its investment in Entity S with the carrying amount of Entity S's share capital (consolidation process).

13. The consolidated statement of financial position at 1 January 2017 resulting from the steps described above is as follows:

Statement of financial position at 1 January 2017	Entity P	Entity S					Adjustments	Consolidated
	GBP	LC	Inflation factor	LC restated for IAS 29	Exchange rate	GBP	GBP	GBP
	A	B	C	D = B × C	E	F = E × D	G	A + F + G
Assets	**400**	**1,000**		**1,000**		**400**	**(400)**	**400**
Investment in Entity S	400	-	-	-	-	-	(400)	-
Non-monetary asset	-	1,000	1	1,000	0.40	400	-	400
Equity and liabilities	**400**	**1,000**		**1,000**		**400**	**(400)**	**400**
Share capital--Entity P	400	-	-	-	-	-	-	400
Share capital--Entity S	-	1,000	1	1,000	0.40	400	(400)	-
Retained earnings	-	-	-		-	-	-	-
Exchange difference (CTA)	-	-	-	-	-	-	-	-
Net income	-	-	-	-	-	-	-	-

Statement of financial position at 31 December 2017

14. Entity P consolidates Entity S's results and financial position as follows:

(a) Step 1: Entity P restates Entity S's non-monetary asset and share capital to reflect inflation at that date. The restated amounts are LC3,000 (LC1,000 × (300÷100) = LC3,000).

(b) Step 2: Entity P translates all items in Entity S's financial statements at the closing rate. The translated amounts of Entity P's non-monetary asset and share capital are GBP750 (LC3,000 × 0.25 = GBP750).

(c) Step 3: Entity P combines items in its financial statements with those of Entity S, and offsets the carrying amount of its investment in Entity S with the carrying amount of Entity S's share capital (consolidation process).

15. The consolidated statement of financial position at 31 December 2017 resulting from the steps described above is as follows:

Statement of financial position at 31 December 2017	Entity P	Entity S					Adjustments	Consolidated
	A	B	C	D = B × C	E	F = E × D	G	A + F + G
Assets	**400**	**1,000**	**-**	**3,000**	**-**	**750**	**(400)**	**750**
Investment in Entity S	400	-	-	-	-	-	(400)	-
Non-monetary asset	-	1,000	3.0	3,000	0.25	750	-	750
Equity and liabilities	**400**	**1,000**	**-**	**3,000**	**-**	**750**	**(750)**	**750**
Share capital--Entity P	400	-	-	-	-	-	-	400
Share capital--Entity S	-	1,000	3.0	3,000	0.25	750	(750)	-
Retained earnings	-	-	-	-	-	-	-	-
Exchange difference (CTA)	-	-	-	-	-	-	-	-
Consolidation difference	-	-	-	-	-	-	-	350
Net income	-	-	-	-	-	-	-	-

16. A difference of GBP350 arises during the consolidation process (consolidation difference). This is because the carrying amount of Entity P's investment in Entity S is GBP400 whereas Entity S's share capital is GBP750 (translated at the closing rate of 0.25).

17. The consolidation difference includes two effects:

(a) a restatement effect of GBP500[4]—this is the effect of restating Entity S's share capital (and non-monetary asset) applying IAS 29; and

(b) a translation effect of GBP(150)—this results from translating Entity S's share capital (excluding any IAS 29 restatement) at the opening and closing rates—LC1,000 × (0.25–0.40) = GBP(150).

18. The submitter asks how Entity P presents this consolidation difference in its consolidated statement of financial position.

[4] Calculated as LC2,000 (LC3,000 restated carrying amount at 31 December 2017 less LC1,000 carrying amount at 1 January 2017), translated at the closing rate of LC1: GBP0.25.

Views

19. The submitter identified three views on how the reporting entity presents this consolidation difference:

    (a) **View A**—present the restatement effect and translation effect separately, ie:

        (i) the restatement effect directly in consolidated equity, and

        (ii) the translation effect in consolidated other comprehensive income (OCI).

    (b) **View B**—present both the restatement effect and the translation effect in consolidated OCI.

    (c) **View C**—present both the restatement effect and the translation effect directly in consolidated equity.

    The submission (reproduced in Appendix A to Agenda Paper 4) provides further details on each of the three views.

20. The table below illustrates how the three views apply to the consolidation difference of GBP350 that arises in the simplified example in this paper (see paragraphs 14–17):

Statement of financial position at 31 December 2017	Consolidated (GBP)		
	View A	*View B*	*View C*
Assets	**750**	**750**	**750**
Investment in Entity S	-	-	-
Non-monetary asset	750	750	750
Equity and liabilities	**750**	**750**	**750**
Share capital--Entity P	400	400	400
Share capital--Entity S	-	-	-
Retained earnings	**500**	**-**	**350**
Exchange difference (CTA)	**(150)**	**350**	**-**
Consolidation difference			
Net income	-	-	-

21. On disposal of a foreign operation, paragraph 48 of IAS 21 requires an entity to reclassify to profit or loss cumulative amounts of exchange differences recognised in OCI. Accordingly, recognising the amounts of the restatement effect and/or the translation effect in OCI would result in the reporting entity reclassifying to profit or loss any such amounts when it disposes of the foreign operation. The reporting entity would not reclassify those amounts to profit or loss if it recognises them directly in equity.

Outreach and additional research performed

22. Paragraphs 8–11 and 15–17 of Agenda Paper 4 for this meeting describe the outreach and additional research performed. The paragraphs below summarise the results of that outreach and research with respect to the matter discussed in this paper.

Outreach

23. We asked respondents how, in their experience, reporting entities present differences that arise on a hyperinflationary foreign operation.

24. Seven respondents provided information on this matter. Two respondents said entities in their jurisdiction present the difference in OCI (ie apply View B) while five said there is diversity in how entities present the difference. These five respondents said:

    (a) most entities present the difference in OCI (ie apply View B) whereas some entities present the difference in equity (ie apply View C); and

    (b) few entities present the restatement effect and translation effect separately—ie few entities apply View A.

Additional research

25. As explained in paragraph 15 of Agenda Paper 4, we reviewed the financial statements of 36 entities to identify the accounting policies applied with respect to the difference.

26. Our research identified 10 entities that disclose a policy of presenting the entire difference in OCI (ie View B) and five entities with a policy of presenting the entire difference in equity (ie View C).

27. The remaining 21 entities do not specifically disclose their accounting policy in this respect—many of these entities disclose that they present in OCI any exchange difference resulting from the use of a presentation currency that is not the functional currency. However, we were unable to assess whether this presentation policy also applies to the consolidation difference.

28. We identified no entities that disclose a policy of presenting a portion of the difference directly in equity and a portion in OCI (ie View A).

Staff analysis

29. Our analysis is structured in three sections:

    (a) the first (paragraphs 30–45 below) analyses the requirements in IAS 21 on the presentation of exchange differences arising on translating a hyperinflationary foreign operation—ie whether such exchange differences are presented in consolidated OCI, consolidated equity, or whether either is possible.

    (b) the second (paragraphs 46–48) considers whether all, or only a part, of the consolidation difference described in the submission is an exchange difference as defined in IAS 21.

    (c) the third (paragraphs 49–56 below) considers the implications of our analysis for the fact pattern described in the submission.

Presenting exchange differences on hyperinflationary foreign operations

30. Paragraph 42 of IAS 21 applies when an entity has a hyperinflationary functional currency and translates its results and financial position into a different presentation currency. That paragraph requires the translation of all amounts (assets, liabilities,

equity items, income and expenses) at the closing rate at the date of the most recent statement of financial position; it does not specify how an entity presents any resulting exchange difference.

31. The requirements in paragraph 42 apply in two situations:

(a) the first (as noted above) is when an entity with a hyperinflationary functional currency presents its financial statements in a different currency (hyperinflationary or non-hyperinflationary).

(b) the second is when a reporting entity translates the financial statements of a hyperinflationary foreign operation into its presentation currency (hyperinflationary or non-hyperinflationary) for inclusion in its consolidated financial statements—this case includes the situation described in the submission[5].

32. Paragraph 42 specifically refers to the first situation (described above in paragraph 31(a)) and, thus, the requirements in paragraph 42 were written with that situation in mind. We think this is reason that paragraph 42 does not specify how an entity presents any resulting exchange difference. In the situation described in paragraph 31(a), exchange differences do not arise on translation into a different presentation currency—this is because the requirement to translate all amounts at the closing rate at the date of the most recent statement of financial position results in the entity recognising no exchange difference on an aggregated basis.

33. The requirement to apply paragraph 42 to the second situation (described above in paragraph 31(b)) is specified in paragraph 44 of IAS 21, within the section of IAS 21 titled ‘translation of a foreign operation’. Exchange differences can arise in that situation, as illustrated in the simplified example developed in this paper[6]. However, paragraph 42 does not explicitly specify how a reporting entity presents any exchange

[5] In the situation described in the submission, a reporting entity translates the financial statements of a hyperinflationary foreign operation into its non-hyperinflationary presentation currency for inclusion in its consolidated financial statements.

[6] Paragraphs 46–48 of this paper consider whether all, or only a part, of the consolidation difference described in the submission is an exchange difference as defined in IAS 21

difference that may arise from the restate/translate process—this is why the submitter has asked this question.

34. Although paragraph 42 does not explicitly specify the presentation of exchange differences arising in the situation described in the submission, we have considered the overall principles and requirements in IAS 21 in assessing the submitter's question—ie whether the reporting entity presents exchange differences in OCI or directly in equity in the situation described in the submission.

Requirements on exchange differences in IAS 21 and IFRIC 16

35. All requirements in IAS 21 that specify the recognition (or presentation) of exchange differences state that exchange differences are recognised (or presented) in profit or loss or OCI; none of those requirements specify the recognition of exchange differences directly in equity.

36. Applying IAS 21, an entity:

    (a) presents in profit or loss any exchange differences resulting from applying (i) paragraphs 28 and 30 (when reporting foreign currency transactions in the functional currency); and (ii) paragraph 45 on eliminating intragroup monetary items (when translating a foreign operation's financial statements).

    (b) presents in OCI any exchange differences resulting from applying (i) paragraphs 30 and 32 (when reporting foreign currency transactions in the functional currency); and (ii) paragraph 39 (when using a presentation currency other than a non-hyperinflationary functional currency). In specifying requirements on disposal of a foreign operation, paragraph 48 refers only to exchange differences presented in OCI—that paragraph applies to both hyperinflationary and non-hyperinflationary foreign operations.

37. IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* applies to an entity that hedges the foreign currency risk arising from its net investment in a foreign operation.

Paragraph 1 of that Interpretation states 'when translating the result and financial position of a foreign operation into a presentation currency, the entity is required to recognise foreign exchange differences in other comprehensive income until it disposes of the foreign operation'. That Interpretation applies to hedges of net investments in both hyperinflationary and non-hyperinflationary foreign operations.

38. In addition, paragraph 52 of IAS 21 specifies requirements to disclose exchange differences. This paragraph states (emphasis added):

> An entity shall disclose:
>
> (a) the amount of *exchange differences recognised in profit or loss* except for those arising on financial instruments measured at fair value through profit or loss in accordance with IFRS 9; and
>
> (b) net *exchange differences recognised in other comprehensive income and accumulated in a separate component of equity*, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

39. We think the requirements in IAS 21 refer to the recognition of exchange differences in profit or loss or OCI (and IFRIC 16 refers only to OCI)—with no reference to equity—because exchange differences meet the definition of income or expenses. Those requirements indicate that neither the Board nor the Committee contemplated the recognition of exchange differences directly in equity applying IAS 21.

40. We think the only basis for recognising exchange differences directly in equity would be that IAS 21 does not explicitly prohibit such an approach. However, in our view, this alone is *not* a basis to support any particular accounting treatment, particularly in this case when exchange differences meet the definition of income or expenses.

Staff conclusion

41. Accordingly, in our view, an entity would not recognise directly in equity exchange differences arising on translation of a hyperinflationary foreign operation.

42. Paragraph 41 of IAS 21 explains why the Standard requires an entity to present in OCI—and not in profit or loss—exchange differences arising on translation from a non-hyperinflationary functional currency into a different presentation currency. It states:

> …These exchange differences are not recognised in profit or loss because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations.

43. That explanation also applies to exchange differences that arise on translation of the financial statements of a hyperinflationary foreign operation into a reporting entity's presentation currency. This is noted in paragraph BC14 of IFRIC 16, which states 'functional currencies create an economic exposure to changes in cash flows or fair values; a presentation currency never will'.

44. Consequently, in our view, a reporting entity presents in OCI any exchange differences arising on translation of a hyperinflationary foreign operation into the reporting entity's presentation currency.

Conclusion on applying the requirements

45. Applying IAS 21, we conclude that an entity presents in OCI exchange differences arising on translating the results and financial position of a hyperinflationary foreign operation.

Is the consolidation difference an exchange difference?

46. Paragraph 8 of IAS 21 defines an exchange difference as:

> …the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.

47. As explained in paragraph 17 of this paper, the consolidation difference includes both a restatement effect and a translation effect. We think an entity could consider that:

(a) only the translation effect meets the definition of an exchange difference. This is because, as illustrated in the example developed in this paper, the translation effect reflects the translation of Entity S's share capital (or, more broadly, Entity S's equity), excluding the effect of any IAS 29 restatement, from the opening to the closing rate—ie this is the translation of a given number of units of one currency into another currency at different exchange rates. The restatement effect does not meet the definition of an exchange difference because it reflects the effect of applying the restatement requirements in IAS 29 to Entity S's equity; it therefore does not result from applying different exchange rates to a given number of units of one currency.

(b) the entire consolidation difference meets the definition of an exchange difference. This is because:

(i) the overall difference results from translating the foreign operation's equity at different exchange rates[7]. In the example used in this paper, the difference is equal to the difference between Entity S's equity (adjusted for inflation) of LC3,000 translated at the closing rate of 0.25 (ie GBP750) less the opening equity of LC1,000 translated at the opening rate of 0.40 (ie GBP400). We acknowledge that the opening and closing equity amounts to which the exchange rates apply are different and, accordingly, it could be said that the different exchange rates are not strictly applied to a *given number of units of one currency*. However, the difference between the opening and closing equity amounts of LC2,000 (LC3,000 – LC1,000) results only from applying the restatement

[7] In the example used in this paper, the difference is equal to the difference between the opening and closing amounts of Entity S's equity:

[Equity $_{\text{opening in LC}}$ × (1 + inflation rate) × Exchange rate $_{\text{closing}}$] – [Equity $_{\text{opening in LC}}$ × Exchange rate $_{\text{opening}}$]

requirements in IAS 29—ie the difference reflects the change in the currency unit of the foreign operation's equity to reflect inflation at the closing date. Accordingly, we think the entire consolidation difference could meet the definition of an exchange difference in IAS 21.

(ii) any difference reflects a phenomenon that is primarily related to foreign exchange rates. Any consolidation difference that is not equal to nil results from the fact that the change in the hyperinflationary currency's foreign exchange rate does not adequately reflect the change in the general price index of the hyperinflationary economy. In other words, if the change in the exchange rate were to fully (and only) reflect the change in price levels, there would be no consolidation difference—from an accounting perspective, this would mean that the amount by which the foreign operation's non-monetary assets and equity are restated applying IAS 29 would be offset by the change in the opening and closing exchange rates. Accordingly, any overall consolidation difference that arises reflects the 'ineffectiveness' of the changes in exchange rates with respect to the inflation rate prevailing in the hyperinflationary economy[8].

48. Applying the definition of an exchange difference in IAS 21, we conclude that both readings are possible. Our analysis below considers both views in assessing how an entity presents the consolidation difference.

[8] The formula in footnote [7] above can mathematically also be expressed as:

$\text{Equity}_{\text{closing in LC}} \times$ [Exchange rate $_{\text{closing}}$ – Exchange rate $_{\text{opening}} \div (1+\text{inflation rate})$]

The term [Exchange rate $_{\text{opening}} \div (1+\text{inflation rate})$] is the exchange rate at the closing rate *that fully reflects inflation* in the hyperinflationary economy. In the light of this formula, the difference can be analysed as foreign exchange inefficiency—ie an exchange difference computed using (a) the observable closing rate and (b) the closing rate that would fully (and only) reflect inflation. The difference is calculated as the foreign operation's closing equity denominated in LC (a given number of units of foreign currency) multiplied by the inefficiency in the foreign exchange rate.

In the example in the submission, the difference of GBP 350 can be calculated as LC3,000 × [0.25 – 0.4÷(1+2)] = GBP350. This difference arises because the closing rate (0.25) is overvalued in comparison to an exchange rate that would fully (and only) reflect inflation (0.13).

Implications of applying the requirements on exchange differences to the fact pattern

49. As discussed above, we conclude that an entity could consider that (a) the entire difference meets the definition of an exchange difference, or (b) only the translation effect meets the definition of an exchange difference. We discuss below the presentation that would result from applying these two views to the requirements discussed in paragraphs 30–45 of this paper.

The entire difference is an exchange difference

50. If an entity considers that the entire difference meets the definition of an exchange difference, applying the conclusion in paragraph 45 of this paper the entity presents the entire difference in OCI (ie it applies accounting that results in an outcome that is similar to View B described in the submission—see paragraph 19 of this paper).

Only the translation effect is an exchange difference

51. If an entity considers that only the translation effect meets the definition of an exchange difference, the translation effect excludes the effect of any IAS 29 restatement—see paragraph 17(b) of this paper. In other words, the exchange difference in this situation is similar to the exchange difference that the reporting entity would have computed on its net investment in the foreign operation had the foreign operation's functional currency *not* been hyperinflationary. If the foreign operation's functional currency had not been hyperinflationary, the reporting entity would have applied paragraph 39(c) of IAS 21[9], thereby recognising the exchange difference in OCI.

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[9] Paragraph 39 of IAS 21 states (emphasis added): 'The results and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:

(a) assets and liabilities for each statement of financial position presented (ie including comparatives) shall be translated at the closing rate at the date of that statement of financial position;

(b) income and expenses for each statement presenting profit or loss and other comprehensive income (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and

(c) all resulting exchange differences shall be *recognised in other comprehensive income*'.

52. Consequently, if the reporting entity considers that only the translation effect meets the definition of an exchange difference, applying the conclusion in paragraph 45 of this paper the entity presents this translation effect in OCI. However, in this situation, the entity would also need to consider how it presents the restatement effect.

Presenting the restatement effect

53. As explained in paragraph 17(a) of this paper, the restatement effect reflects the amount by which the currency unit of the foreign operation's equity has been restated. Applying paragraph 25 of IAS 29, the foreign operation would reflect such restatements as a change in its equity if the foreign operation were to prepare separate financial statements. Paragraph 25 of IAS 29 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. The movements for the period in owners' equity are disclosed in accordance with IAS 1.

54. We have identified no requirement in IAS 21 or another IFRS Standard that would require the entity to include the difference elsewhere and thereby override the requirements in paragraph 25 of IAS 29. Accordingly, we think the reporting entity presents the restatement effect in consolidated equity.

Conclusion about how an entity presents the difference when only the translation effect is an exchange difference

55. Based on our analysis in paragraphs 51–54 of this paper, an entity presents:

    (a) the restatement effect in consolidated equity; and

    (b) the translation effect in consolidated OCI.

56. Applying the conclusion in paragraph 55 above results in accounting similar to that described in View A in paragraph 19 of this paper.

Staff conclusion

57. Having considered the possible ways of analysing the consolidation difference, we conclude that there are two acceptable approaches for presenting such a difference—ie the reporting entity presents the difference either:

   (a) in OCI in its entirety, if the entity considers that the entire difference meets the definition of an exchange difference in IAS 21; or

   (b) separately (i) in equity (to reflect the restatement effect) and (ii) in OCI (to reflect the translation effect). This presentation applies when an entity considers that only the translation effect meets the definition of an exchange difference in IAS 21.

58. In the light of the views described in paragraph 19 of this paper, we conclude that a reporting entity could apply either View A or View B to present the consolidation difference, depending on their view of whether all or part of the consolidation difference meets the definition of an exchange difference in IAS 21.

59. Applying the requirements in paragraph 13 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*[10], the reporting entity would apply its accounting policy consistently to all its hyperinflationary foreign operations.

60. The reporting entity would accumulate any amount presented in OCI in a separate component of equity. Applying the requirements in paragraph 48 of IAS 21, it would reclassify this amount to profit or loss when it disposes of, or partially disposes of, the foreign operation.

[10] Paragraph 13 of IAS 8 states: 'an entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an IFRS specifically requires or permits categorisation of items for which different policies may be appropriate…'

Question 1 for the Committee

Does the Committee agree with our analysis and conclusion, set out in paragraphs 29–60 of this paper, that, depending on its view of whether all or part of the consolidation difference meets the definition of an exchange difference in IAS 21, the reporting entity presents the consolidation difference either in :

(a) consolidated OCI, or

(b) separately, with one component presented in consolidated OCI (translation effect) and the other component in consolidated equity (restatement effect)?

Should the Committee add this matter to its standard setting agenda?

61. Based on our analysis, we think entities could apply either one of the two acceptable approaches described in paragraph 57 of this paper to present the consolidation difference arising from restating and translating a hyperinflationary foreign operation.

62. The responses to outreach and our additional research indicate that few, if any, entities apply the approach described in paragraph 57(b) of this paper—ie few entities present the consolidation difference separately with one component presented in consolidated OCI (translation effect) and the other component in consolidated equity (restatement effect). Accordingly, there is limited evidence of diversity in reporting practices between the two approaches described in paragraph 57 of this paper.

63. Furthermore, we would expect any diversity to remain limited. This is because we do not expect entities to apply the approach described in paragraph 57(b) of this paper—we understand that this approach might be complex and costly to implement.

64. Accordingly, the Committee has not obtained evidence that a project would result in an improvement in financial reporting that would be sufficient to outweigh the costs.

Staff recommendation

65. On the basis of our assessment of the Committee's agenda criteria in paragraphs 5.16–5.17 of the *Due Process Handbook* (discussed in paragraphs 61–64 above), we recommend the Committee not add this matter to its standard-setting agenda. Instead, we recommend that the Committee publish a tentative agenda decision that explains how an entity applies the requirements in IAS 21 and IAS 29 to the fact pattern described in the submission.

66. Appendix A to this paper outlines the proposed wording of the tentative agenda decision.

Questions 2 and 3 for the Committee
2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—Proposed wording of the tentative agenda decision

Presenting Exchange Differences when a Foreign Operation is Hyperinflationary (IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*)

The Committee received a request about the application of IAS 21 and IAS 29. In the fact pattern described in the request, the entity:

(a) has a presentation currency that is not the currency of a hyperinflationary economy as defined in IAS 29;

(b) has a foreign operation with a functional currency that is the currency of a hyperinflationary economy as defined in IAS 29 (hyperinflationary foreign operation); and

(c) in preparing its consolidated financial statements, translates the results and financial position of the hyperinflationary foreign operation into its presentation currency.

Paragraph 43 of IAS 21 requires an entity to restate the results and financial position of a hyperinflationary foreign operation applying IAS 29 before applying the translation method set out in paragraph 42 of IAS 21 (restate/translate approach). The application of the restate/translate approach may result in a change to the entity's net investment in the hyperinflationary foreign operation. This change would include two effects:

(a) a restatement effect resulting from restating the hyperinflationary foreign operation's results and financial position applying IAS 29; and

(b) a translation effect resulting from translating the entity's interest in the net assets of the hyperinflationary foreign operation at a closing rate that differs from the previous closing rate.

The request asked how the entity presents the restatement and translation effects in its statement of financial position.

Do the restatement and translation effects meet the definition of an exchange difference?

The Committee observed that paragraph 8 of IAS 21 defines an exchange difference as 'the difference resulting from translating a given number of units of one currency into another currency at different exchange rates'. Applying this definition, the Committee concluded that either only the translation effect, or the combination of the restatement and translation effects, meets the definition of an exchange difference.

How does an entity present any exchange difference arising from translating a hyperinflationary foreign operation?

The Committee observed that all requirements in IAS 21 that specify the recognition (or presentation) of exchange differences require an entity to recognise (or present) exchange differences in profit or loss or other comprehensive income (OCI).

IAS 21 requires the recognition of exchange differences in profit or loss or OCI—with no reference to equity—because exchange differences meet the definition of income or expenses. Accordingly, the Committee concluded that an entity does not recognise exchange differences directly in equity.

Paragraph 41 of IAS 21 specifies why paragraph 39(c) of IAS 21 requires an entity whose functional currency is not the currency of a hyperinflationary economy to present in OCI—and not in profit or loss—any exchange difference arising when the entity's results and financial position are translated into a non-hyperinflationary presentation currency. The Committee observed that this explanation also applies if the functional currency is hyperinflationary. Accordingly, the Committee concluded that an entity presents in OCI any exchange difference resulting from the translation of a hyperinflationary foreign operation.

Applying the requirements in IFRS Standards to the restatement and translation effects

The Committee concluded that, in the fact pattern described in the request, the entity presents:

(a) the restatement and translation effects in OCI, if the entity considers that the combination of those two effects meets the definition of an exchange difference in IAS 21; or

(b) the translation effect in OCI, if the entity considers that only this translation effect meets the definition of an exchange difference in IAS 21. In this case, consistent with the requirements in paragraph 25 of IAS 29, the entity would present the restatement effect in equity.

In the light of its analysis, the Committee considered whether to add a project on the presentation of exchange differences arising from the restatement and translation of hyperinflationary foreign operations to its standard-setting agenda. On the basis of responses to outreach and additional research performed, the Committee observed little, if any, diversity in reporting between the two approaches outlined in this agenda decision. Therefore the Committee has not obtained evidence that a project would result in an improvement in financial reporting that would be sufficient to outweigh the costs. Consequently, the Committee [decided] not to add the matter to its standard-setting agenda.