IFRS Accounting

Staff paper

Agenda reference: 5

IFRS® Interpretations Committee meeting

Date	**June 2023**
Project	**Consolidation of a Non-Hyperinflationary Subsidiary by a Hyperinflationary Parent (IAS 21 and IAS 29)**
Topic	**Cover paper**
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Introduction

1. At its June 2022 meeting, the IFRS Interpretations Committee (Committee) discussed a submission about the accounting applied by a parent, whose functional currency is the currency of a hyperinflationary economy, when it consolidates a subsidiary, whose functional currency is the currency of a non-hyperinflationary economy.

2. The Committee concluded that, applying IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*, the parent could restate or not restate the subsidiary's results and financial position in terms of the measuring unit current at the end of the reporting period.[1] Accordingly, the Committee directed us to conduct further research and outreach to help the Committee decide whether to refer the matter to the IASB by recommending that the IASB develop a narrow-scope amendment.[2]

[1] For ease of reference, Agenda Papers 5–5C to this meeting refer to 'current measuring unit' when we talk about the measuring unit current at the end of the reporting period.

[2] For ease of reference, Agenda Papers 5–5C to this meeting refer to 'additional research' when we talk about our further research and outreach.

3. The purpose of this meeting is to:

   (a) provide the Committee with findings from our additional research together with our analysis and recommendations; and

   (b) ask the Committee whether it agrees with our recommendation and our preliminary views on a possible solution to address the matter.

Structure and papers for this meeting

4. This agenda paper includes:

   (a) a summary of our recommendations and preliminary views;

   (b) background information;

   (c) questions to the Committee; and

   (d) two appendices:

      (i) Appendix A—extracts from IAS 21 and IAS 29; and

      (ii) Appendix B—extracts from June agenda paper.

5. Agenda Papers 5A–5C for this meeting include:

   (a) a summary of additional research (Agenda Paper 5A);

   (b) analysis and recommendations about whether to add a standard-setting project to the work plan and the scope of such a project (Agenda Paper 5B); and

   (c) analysis and preliminary views about a possible solution (Agenda Paper 5C).

Summary of staff recommendations and preliminary views

6. We recommend the Committee refers the matter to the IASB by recommending that the IASB develop a narrow-scope amendment that addresses:

   (a) the submitted fact pattern described in paragraph 1; and

(b) a related matter of an entity whose functional currency is the currency of a non-hyperinflationary economy but that presents its financial statements in a currency of a hyperinflationary economy.[3]

7. Our preliminary view is that the IASB should amend IAS 21 to require a reporting entity to translate all items (assets, liabilities, equity items, income and expenses, including comparatives) at the most recent closing rate when the entity:

(a) has a non-hyperinflationary functional currency and presents financial statements in a hyperinflationary presentation currency; and

(b) translates the results and financial position of a foreign operation that has a non-hyperinflationary functional currency into a hyperinflationary presentation currency.

Background information

8. Agenda paper 2 of the Committee's June 2022 meeting (June agenda paper) explains the fact pattern described in the submission. In that fact pattern, a parent entity has:

(a) a functional and presentation currency that is the currency of a hyperinflationary economy; and

(b) a subsidiary with a functional currency that is the currency of a non-hyperinflationary economy.[4]

9. When preparing its consolidated financial statements, the hyperinflationary parent applies paragraphs 39–41 of IAS 21 to translate the non-hyperinflationary

[3] For ease of reference, Agenda Papers 5–5C to this meeting refer to:

(a) 'submitted fact pattern' when we talk about a parent, whose functional currency is the currency of a hyperinflationary economy, that consolidates a subsidiary, whose functional currency is the currency of a non-hyperinflationary economy; and

(b) 'related matter' when we talk about an entity whose functional currency is the currency of a non-hyperinflationary economy but that presents its financial statements in a currency of a hyperinflationary economy.

[4] For ease of reference, Agenda Papers 5–5C to this meeting refer to the parent as a 'hyperinflationary parent' and the subsidiary as a 'non-hyperinflationary subsidiary'. These agenda papers also refer to the currency of a hyperinflationary economy as a 'hyperinflationary currency' and the currency of a non-hyperinflationary economy as a 'non-hyperinflationary currency'.

subsidiary's results and financial position into the presentation currency of the hyperinflationary parent.[5] Applying these paragraphs, the hyperinflationary parent:

(a) translates the subsidiary's assets and liabilities (including comparative information) at the closing rate at the date of that statement of financial position;

(b) translates the subsidiary's income and expenses (including comparative information) at exchange rates at the dates of the transactions; and

(c) recognises resulting exchange differences in other comprehensive income.

10. The question asked was whether, after applying paragraphs 39–41 of IAS 21, the hyperinflationary parent applies paragraphs 26 and 34 of IAS 29 to restate the current period income and expenses and all comparative information of the non-hyperinflationary subsidiary in terms of the current measuring unit. Applying IAS 21, the assets and liabilities of the subsidiary as at the end of the current reporting period are translated at the closing rate at that date—consequently these are already expressed in terms of the current measuring unit and there was no question about whether to restate the subsidiary's assets and liabilities applying paragraphs 11–25 of IAS 29.

11. If the hyperinflationary parent were to not apply paragraphs 26 and 34 of IAS 29 (View 1), it would do nothing beyond what paragraph 9 describes.

12. However, if the hyperinflationary parent were to apply paragraphs 26 and 34 of IAS 29 (View 2) the parent, in addition to what paragraph 9 describes:

(a) applies to the subsidiary's current period income and expenses the change in the general price index from the dates the income and expenses were initially recognised. Applying IAS 21, the subsidiary's income and expenses are translated at the exchange rates at the dates of the transactions and, proponents

[5] Appendix A to this paper includes the relevant extracts of IAS 21 *The Effects of Changes in Foreign Exchange Rates* and IAS 29 *Financial Reporting in Hyperinflationary Economies*.

of View 2 are of the view that the income and expenses need to be restated in terms of the current measuring unit.

(b) recognises any restatement gain or loss. Restating the subsidiary's income and expenses as discussed in (a) and not restating assets and liabilities creates a corresponding restatement gain or loss. The Committee did not discuss how or where in the financial statements the hyperinflationary parent recognises this gain or loss.

(c) applies to the subsidiary's comparative information (assets, liabilities, equity items, income and expenses) the change in the general price index from the beginning of the reporting period—ie current period inflation. Proponents of View 2 say the comparative information needs to be restated in terms of the current measuring unit. No restatement gain or loss arises because the same change in the general price index is applied to all items in the comparative financial statements.

13. The June agenda paper explains the rationale for the two views and includes a simplified example that illustrates the submitted fact pattern and some aspects of applying the two different views. For ease of reference, Appendix B includes relevant extracts from the June agenda paper.

14. At the June 2022 Committee meeting:

(a) some Committee members were of the view that an entity cannot apply paragraph 26 and 34 of IAS 29;

(b) some Committee members were of the view that an entity is required to apply paragraph 26 and 34 of IAS 29 (as described in paragraph 12); and

(c) some Committee members were of the view that both treatments are permissible.

15. Consequently, the Committee concluded that in the submitted fact pattern, the hyperinflationary parent could restate or not restate the subsidiary's income and expenses and comparative information in terms of the current measuring unit.

16. Considering this conclusion, the Committee asked us to conduct additional research before deciding whether to refer the matter to the IASB. Agenda Paper 5A summarises our approach to, and the results of, the additional research.

17. Agenda Paper 5B discusses whether the Committee should refer the matter to the IASB by recommending that the IASB develop a narrow-scope amendment and the scope of such a project. Agenda Paper 5C discusses a possible solution to address the matters within the scope of such a project.

Questions to the Committee
Considering our analysis in Agenda Papers 5A–5C, does the Committee: 1. agree with our recommendation as set out in paragraph 6 of this paper; and 2. have any questions or comments about our preliminary view about a possible solution summarised in paragraph 7 of this paper.

Appendix A—Extracts from IAS 21 and IAS 29

IAS 21 The Effects of Changes in Foreign Exchange Rates

Translation to the presentation currency

…

39 **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.

40 For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

41 The exchange differences referred to in paragraph 39(c) result from:

(a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate.

(b) translating the opening net assets at a closing rate that differs from the previous closing rate.

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. The cumulative amount of the exchange differences is presented in a separate component of equity until disposal of the foreign operation. When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to non-controlling interests are allocated to, and recognised as part of, non-controlling interests in the consolidated statement of financial position.

42 The results and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:

(a) all amounts (ie assets, liabilities, equity items, income and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent statement of financial position, except that

(b) when amounts are translated into the currency of a non-hyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (ie not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).

43 **When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with IAS 29 before applying the translation method set out in paragraph 42, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy (see paragraph 42(b)). When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements in accordance with IAS 29, it shall use as the historical costs for translation into the presentation currency the amounts restated to the price level at the date the entity ceased restating its financial statements.**

Translation of a foreign operation

44 Paragraphs 45–47, in addition to paragraphs 38–43, apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation or the equity method.

IAS 29 Financial Reporting in Hyperinflationary Economies

1 **This Standard shall be applied to the financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.**

2 In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

…

7 In a hyperinflationary economy, financial statements, whether they are based on a historical cost approach or a current cost approach, are useful only if they are expressed in terms of the measuring unit current at the end of the reporting period. As a result, this Standard applies to the financial statements of entities reporting in the currency of a hyperinflationary economy. Presentation of the information required by this Standard as a supplement to unrestated financial statements is not permitted. Furthermore, separate presentation of the financial statements before restatement is discouraged.

8 **The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy, whether they are based on a historical cost approach or a current cost approach, shall be stated in terms of the measuring unit current at the end of the reporting period. The corresponding figures for the**

previous period required by IAS 1 Presentation of Financial Statements (as revised in 2007) and any information in respect of earlier periods shall also be stated in terms of the measuring unit current at the end of the reporting period. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 42(b) and 43 of IAS 21 *The Effects of Changes in Foreign Exchange Rates* apply.

…

26 This Standard requires that all items in the statement of comprehensive income are expressed in terms of the measuring unit current at the end of the reporting period. Therefore all amounts need to be restated by applying the change in the general price index from the dates when the items of income and expenses were initially recorded in the financial statements.

…

34 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. Information that is disclosed in respect of earlier periods is also expressed in terms of the measuring unit current at the end of the reporting period. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 42(b) and 43 of IAS 21 apply.

…

35 A parent that reports in the currency of a hyperinflationary economy may have subsidiaries that also report in the currencies of hyperinflationary economies. The financial statements of any such subsidiary need to be restated by applying a general price index of the country in whose currency it reports before they are included in the consolidated financial statements issued by its parent. Where such a subsidiary is a foreign subsidiary, its restated financial statements are translated at closing rates. The financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21.

Appendix B—Extracts from June agenda paper

Simplified example

B1. Assume Entity P (a parent) has a reporting date of 31 December, and a functional and presentation currency (HC) that is the currency of a hyperinflationary economy. Entity P owns 100% of the equity of Entity S (a subsidiary).

B2. Entity S:

(a) has a functional currency (NHC) that is the currency of a non-hyperinflationary economy;

(b) was set up on 1 January 20X0 through an investment of HC1,000 by Entity P—the exchange rate on that date was NHC1: HC1, which resulted in an investment of NHC1,000 in Entity S;

(c) used the proceeds of this investment to buy a non-depreciable non-monetary asset for NHC1,000 on 1 January 20X0;

(d) generated revenue and cost of sales of NHC100 and NHC80 respectively in 20X0 and 20X1; and

(e) has cash of NHC20 and NHC40 at 31 December 20X0 and 20X1 respectively.

B3. The exchange rates between the two currencies are:

(a) 1 January 20X0: NHC1: HC1

(b) 31 December 20X0: NHC1: HC4

(c) 31 December 20X1: NHC1: HC15

(d) average rate during 20X0: NHC1: HC2.5

(e) average rate during 20X1: NHC1: HC10

B4. The Consumer Price Index of the hyperinflationary economy in which Entity P operates is:

(a) 31 December 20X0: 100

(b) 31 December 20X1: 300

(c) average price index during 20X0: 75

(d) average price index during 20X1: 225

B5. Entity S's results and financial position at 31 December 20X0 and 20X1 (before applying paragraph 39 of IAS 21) are:

	20X0 (NHC)	20X1 (NHC)
Results		
Revenue	100	100
Cost of sales	(80)	(80)
Financial position		
Cash	20	40
Non-depreciable non-monetary asset	1,000	1,000

Applying paragraph 39 of IAS 21

B6. Applying paragraph 39 of IAS 21, Entity P translates Entity S's results and financial position at the average rate[1] and closing rate respectively. The tables[2] below show Entity S's results and financial position at 31 December 20X0 and 20X1:

	20X0 (NHC)	20X0 exchange rate	20X0 (HC)
	A	B	C = A x B
Results			
Revenue	100	2.5	250
Cost of sales	(80)	2.5	(200)
Financial position			
Cash	20	4	80
Non-depreciable non-monetary asset	1,000	4	4,000

	20X1 (NHC)	20X1 exchange rate	20X1 (HC)
	A	B	C = A x B
Results			
Revenue	100	10	1,000

[1] Entity P translates income and expenses at exchange rates at the dates of the transactions. For practical reasons, the average rate for the period is used (paragraph 40 of IAS 21).

[2] The example does not illustrate the resulting exchange differences from translation that Entity P recognises in other comprehensive income (paragraph 39(c) of IAS 21).

Cost of sales	(80)	10	(800)
Financial position			
Cash	40	15	600
Non-depreciable non-monetary asset	1,000	15	15,000

	20X0 (HC)	20X1 (HC)
Results		
Revenue	250	1,000
Cost of sales	(200)	(800)
Financial position		
Cash	80	600
Non-depreciable non-monetary asset	4,000	15,000

View I

B7. If Entity P were to apply View I, Entity S's results and financial position at 31 December 20X0 and 20X1—included in Entity P's consolidated financial statements—are as illustrated above.

View II

B8. If Entity P were to apply View II, Entity S's results and financial position (current year and comparative amounts) included in Entity P's consolidated financial statements at 31 December 20X1 are:

Entity S's results and financial position at 31 December 20X1 expressed in terms of the measuring unit current at 31 December 20X1

	20X1 (HC)	Change in price index	Restated (HC)
	C	D	E = C x D
Results			
Revenue	1,000	1.3[3]	1,333
Cost of sales	(800)	1.3	(1,067)
Financial position			
Cash	600	1[4]	600

[3] Because income and expenses are translated using the average rate during 20X1, restatement to the measuring unit current at 31 December 20X1 requires applying the change in price index from the average price index during 20X1 to the price index at 31 December 20X1, ie 300 ÷ 225 ≈ 1.3.

[4] There is no further adjustment because Entity S's assets are translated into HC using the exchange rate at 31 December 20X1, which means the amounts are already stated in terms of the measuring unit current at that date.

Non-depreciable non-monetary asset	15,000	1	15,000

Entity S's results and financial position at 31 December 20X0 (comparatives) expressed in terms of the measuring unit current at 31 December 20X1

	20X0 (HC)	Change in price index	Restated (HC)
	C	D	E = C x D
Results			
Revenue	250	4[5]	1,000
Cost of sales	(200)	4	(800)
Financial position			
Cash	80	3[6]	240
Non-depreciable non-monetary asset	4,000	3	12,000

Entity S's results and financial position at 31 December 20X1 (stated in terms of the measuring unit current at that date)

	20X0 comparatives (HC)	20X1 (HC)
Results		
Revenue	1,000	1,333
Cost of sales	(800)	(1,067)
Financial position		
Cash	240	600
Non-depreciable non-monetary asset	12,000	15,000[7]

View I—Entity P does not restate Entity S's results and financial position

B9. Applying View I, Entity P does not restate Entity S's results and financial position after applying IAS 21 to translate those amounts from NHC to HC.

B10. Proponents of View I highlight the requirement in the last sentence of paragraph 35 of IAS 29, which states 'the financial statements of subsidiaries that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IAS 21'.

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[5] Because income and expenses are translated using the average rate during 20X0, restatement to the measuring unit current at 31 December 20X1 requires applying the change in price index from the average price index during 20X0 to the price index at 31 December 20X1, ie 300 ÷ 75 = 4.

[6] Restatement to the measuring unit current at 31 December 20X1 requires applying the change in price index from 31 December 20X0 to 31 December 20X1, ie 300 ÷ 100 = 3.

[7] The difference in the carrying amount (in HC) of the non-depreciable non-monetary asset arises because the change in closing rate from 31 December 20X0 to 31 December 20X1 does not move in tandem with the change in price index (the change in exchange rate is greater than the change in price index). If the change in closing rate were to move in tandem with the change in price index, ie closing rate at 31 December 20X1 is NHC1 : HC12, the carrying amount of the non-depreciable non-monetary asset would be HC12,000 (NHC1,000 x 12).

In their view, this requirement is clear in explaining that Entity P applies IAS 21 in translating the financial statements of Entity S for inclusion in its consolidated financial statements, and only IAS 21. The objective and requirements in IAS 29 that require financial statements to be restated in terms of the measuring unit current at the reporting date apply only to entities within a group whose functional currency is that of a hyperinflationary economy.

View II—Entity P restates Entity S's results and financial position

B11. Applying View II, Entity P restates Entity S's results and financial position in terms of the measuring unit current at the reporting date, after applying IAS 21 to translate those amounts from NHC to HC.

B12. Proponents of View II highlight requirements in IAS 29 that explain the reason for restating the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy in terms of the measuring unit current at the reporting date. They:

(a) note that paragraph 1 includes within the scope of IAS 29 the *consolidated financial statements* of any entity whose functional currency is that of a hyperinflationary economy.

(b) refer to the overall objective and requirements in IAS 29 that require the financial statements (including current year and comparative amounts) to be stated in terms of the measuring unit current at the reporting date (paragraphs 2, 7, 8 and 34 of IAS 29, reproduced in Appendix A of this paper).

(c) consider that, in applying View II, Entity P complies with the requirement in paragraph 35 to deal with the financial statements of Entity S in accordance with IAS 21. They read the requirements in paragraph 35 as not preventing Entity P from restating Entity S's financial statements after having applied paragraphs 39–41 of IAS 21.

(d) note the requirement in paragraph 36, which states 'if financial statements with different ends of the reporting periods are consolidated, all items, whether non-monetary or monetary, need to be restated into the measuring unit current at the date of the consolidated financial statements'. That requirement does not differentiate between hyperinflationary and non-hyperinflationary subsidiaries. It would therefore appear to suggest that the financial statements of all subsidiaries (including non-hyperinflationary subsidiaries) need to be restated in terms of the measuring unit current at the date of the consolidated financial statements.